Participant Guide

BORROWING BASICS

FDIC Money Smart for Young Adults

Building: Knowledge, Security, Confidence

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YOUR GUIDES

Some students from Lakeview High are going to be your guides in this lesson. Join them throughout the module in working through some financial situations of their own!

RAMÓN
Hobbies: Movies or mini golf with his girlfriend
School life: Plays on the soccer team
Family: Born in the U.S. but his parents are from Peru; a little sister, and an older brother who is a pilot in the Air Force
Job: Repairing computers; wants to work for NASA someday
Future plans: College on a soccer scholarship to study engineering

GRACE
Hobbies: Art, drawing fashion sketches
School life: Prefers not to get into the high school “scene”
Family: Two parents, no siblings
Job: Clothing store at the mall
Future plans: Wants to go to Fashion Design School; her parents want her to go to college; careful with her money so she can buy art supplies

TODD
Personality: Shy, good sense of humor, intelligent
School life: Likes school but doesn’t work very hard at it
Job: Two part-time jobs (fast food and a grocery store)
Family: Mom and sister
Future plans: Plans to attend college but not sure where to go or how to pay for it, but is saving all he can

JASMINE
Hobbies: Hanging out with friends, shopping, collecting teddy bears
School life: Likes English class, swims on the swim team
Job: Weekends and holidays at her aunt’s gift shop
Family: Younger brother named Dominique, large extended family
Future plans: In-state college, plans to be an exercise physiologist

PRE-ASSESSMENT

1. CREDIT IS:

a. Money you borrow.
b. A gift from the credit card company.
c. The rate of a loan.
d. Available only to people with savings accounts.

2. CREDIT IS IMPORTANT BECAUSE: (CIRCLE ALL THAT ARE TRUE.)

a. It can affect your ability to obtain employment, housing, and insurance. depending on how you manage it.
b. It can be useful in times of emergencies.
c. If you don’t have a credit report, you can’t get a student loan.
d. It allows you to make a large purchase, such as a car or a house, and pay for it over time.

3. A HOME EQUITY LOAN:

a. Replaces a mortgage at a lower interest rate.
b. Has the same monthly payment.
c. Is a loan designed for purchasing a house.
d. Can be used to pay for any kind of expense.

4. AN INSTALLMENT LOAN:

a. Always has changing interest rates.
b. Generally has the same payment every month.
c. Can be used like a check.
d. Is the same as rent-to-own agreements.

5. WHICH OF THE FOLLOWING STATEMENTS IS THE MOST ACCURATE?

a. Lenders will only lend to people who have collateral.
b. Lenders are interested in knowing whether the borrower has a job and can make the loan payments.
c. Lenders want to know if the borrower has the capacity, capital, character and collateral to be creditworthy.
d. Lenders want to know if the borrower has the character and assets and savings to be creditworthy.

CHECKING IN

Welcome to *Borrowing Basics*! Learning to manage credit is an important part of building your financial future. This module will teach you about borrowing money from banks and other financial institutions. You will learn how loans work, and how financial institutions make loan decisions.

PURPOSE The *Borrowing Basics* module will help you learn how to use credit appropriately and determine what forms of credit best suit your needs.

OBJECTIVES By the end of this module, you will be able to:

- 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.
- Identify how you can guard against predatory lending practices.
- Explain why it is important to be wary of rent-to-own and refund anticipation services.

AGENDA AND GROUND RULES

If you have experience or knowledge in some aspect of the training material, please share your ideas with the class. One of the best ways to learn is from each other. You might be aware of some method that has worked well for you or some pitfall to avoid. Your contributions to the class will make the learning experience that much better.

STUDENT MATERIALS

Each of you has a copy of the *Borrowing Basics Participant Guide*. It contains:

- Materials and instructions you will need to complete the exercises.
- Checklists and tip sheets related to the module content.
- Space for you to take notes.
- A glossary of the terms used in this module.

Do you have any questions about the module overview?

INCREASING YOUR WEALTH

BORROWING BASICS

WHAT IS CREDIT?

Credit is the ability to borrow money. When you borrow money on credit, you get a loan. You make a promise to pay back the money you borrowed plus some extra. The extra amount is part of the cost of borrowing money.

If you use credit carefully, it can be useful to you. If you are not careful in the way you use credit, it can cause problems.

"Good credit" means that you can be trusted to make your loan payments on time to repay the money you owe. If you have a good credit record, it will be easier to borrow money in the future.

Lead a discussion with students. Write responses on chart paper.

What types of things do you purchase on credit? Why would you purchase them on credit? After reading the cartoon above, explain if Ramón's "deal" was a good deal. Why or why not?

WHY IS CREDIT IMPORTANT?

- It can be useful in times of emergencies.
- It is sometimes more convenient than carrying large amounts of cash.
- It allows you to make a large purchase, such as a car or a house, and pay for it over time.
- If you don't manage your credit well, it can affect your ability to get a job, rent an apartment, and secure car insurance.

TYPES OF LOANS

At some point in your life, you will need to borrow money. If you want to purchase a car or a house, you may need to get a loan. There are three types of loans. They are:

- Credit cards
- Consumer installment loans
- Home loans

CREDIT CARDS

Credit cards give you the ongoing ability to borrow money.

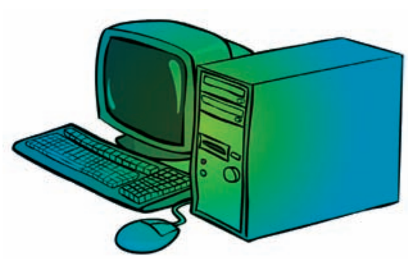
With a credit card, you can buy things without actually having the money right away. However, this can get you into big trouble if you aren't careful. You need to be able to pay your monthly credit card bill. There is more information about credit cards in the Money Smart Charge It Right module.

CONSUMER INSTALLMENT LOANS

A consumer installment loan is used to buy personal items for you and your family. It is called an "installment loan" because you pay the same amount each month in installments. Examples are:

- Automobiles
- Computers

For example, with her birthday money, Grace decides to buy a new laptop. She paid $250 as a down payment and got an installment loan for the rest, the balance. She pays in installment payments of $100 per month for 12 months.



HOME LOANS

The third type of loan is a home loan. There are three main types of home loans:

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

All three loans are based on the value of the home. If the borrower does not pay back the loan on time, the lender can take possession of the home.

Home purchase loans are made for the purpose of buying a house. They are usually called mortgages.

Home refinancing is a process by which an existing home loan (or mortgage) is paid off and replaced with a new loan. Reasons homeowners might want to refinance their home loan include getting:

- A lower interest rate.
- Money for home repairs or improvements.
- Money for other needs.
- A way to consolidate debts.

Home equity loans can be used for any reason. The amount that a person can borrow depends on the amount of "equity" they have in the house. Sometimes banks will give the borrower a checkbook to use to borrow money. It looks like a normal check, but in fact it is a loan that the borrower has to start paying back right away.

ACTIVITY 1: TYPES OF LOANS

Identify the type of loan best suited for the purchase of specific items.

Look at Activity 1 in the Course Activities section.

Do you have any questions about types of loans?

THE COST OF CREDIT

When you get a loan, there are generally two costs you must pay: fees and interest.

FEES

Fees are charged by financial institutions for activities such as servicing the account and reviewing your loan application. For example:

- A credit card company might charge you an annual fee of $30.
- A credit card company will probably also charge fees when you get a cash advance or when your balance exceeds your credit limit. (Your credit limit is how much money the credit card issuer agreed to loan to you.)
- A lender might charge a $25 late fee when you do not pay your bill on time.

INTEREST

Interest is the amount of money a financial institution charges for letting you use its money. The interest rate can be either fixed or variable.

- Fixed rate means the interest rate stays the same throughout the term of the loan.
- Variable rate means the interest rate may change during the loan term. The loan agreement will explain how the rate may change.

TRUTH IN LENDING DISCLOSURES

How Much Does Credit REALLY Cost?

The federal Truth In Lending law requires banks to state charges in a clear and uniform manner so you can easily see the cost of borrowing money. This law allows you to comparison shop between lenders for credit cards and other loans.

WHAT LENDERS MUST DISCLOSE

Amount financed: The amount of the loan the lender is letting you borrow.

Annual Percentage Rate (APR): The cost of your loan expressed as a yearly percentage rate. Using an APR of 12 percent as the example. The APR reflects the total cost of lending rather than just the interest charge. It is the primary tool you should use to compare lending options. The law generally requires that the APR appear in 18-point font on most credit card applications so it is easily seen.

Finance charge: The total dollar amount the loan will cost you. It includes items such as interest, service charges, and loan fees. For example for a loan of $5,000 where the interest is 12% APR, the finance charge total is $600.

Total payments: The amount you will have paid after you have made all payments as scheduled. In the example, the total payment is $5,600.

INTEREST
+
SERVICE CHARGE
+
LOAN FEES

= FINANCE CHARGE

In the example, the total payment is $5,600 for one year. If this loan were for a two-year term, the monthly payments would be lower. However, you will end up paying more interest in the end.

Two terms associated with credit card APRs with which you should be aware are "penalty APR" and "universal default."

PENALTY APR

The terms of your credit card agreement may provide that the creditor will permanently increase the interest rate on your credit card by a large amount if you do not pay your credit card bill on time or if you exceed your credit limit.

For example, the penalty rate may apply if you are late on more than two payments in a six-month period. The Truth in Lending disclosures will provide details on whether the creditor has penalty APRs and when they apply.

UNIVERSAL DEFAULT

A related concept is universal default. Some lenders have policies that will raise your credit card interest rate to the highest possible rate if you are late on any other account.

Example: If you have 5 credit cards and you are late on one, the interest rate for the other four cards may be increased by a large amount.

The Truth in Lending disclosures will tell you if your lender has such a policy.

ACTIVITY 2: BORROWING MONEY RESPONSIBLY

Borrowed money always must be repaid. Sometimes it is responsible to borrow money and sometimes it will get you into debt that you can't control.

Look at Activity 2 in the Course Activities section.
Answer each question.

EQUAL CREDIT OPPORTUNITY ACT

The Equal Credit Opportunity Act (ECOA) ensures that all people are given an equal chance to obtain credit. This doesn't mean all those who apply for credit get it: factors such as income, expenses, debt, and credit history are legitimate considerations for creditworthiness. Rather, the law prohibits a bank from discriminating against you because of your race, color, marital status, religion, national origin, age, receipt of public assistance, or whether you are male or female when deciding whether to issue you a loan.

HOW CREDIT DECISIONS ARE MADE

THE FOUR Cs OF CREDIT DECISION MAKING

When you apply for credit, the lender will review the "Four Cs" to decide whether you are a good credit risk, or in other words, whether you are likely to pay back the loan.

- **Capacity** refers to your present and future ability to meet your payments.
- **Capital** refers to the value of your assets and your net worth.
- **Character** refers to how you have paid your bills or debts in the past.
- **Collateral** refers to property or assets offered to secure the loan.

CAPACITY

Capacity refers to your present and future ability to meet your payments. Lenders will ask:

- Do you have a job?

Generally, a lender would like to see that you have a job and have held the same job or same type of job for at least a year.

- How much money do you make each month?
- What are your monthly expenses?

A bank will compare your monthly loan payments, if any, and your other monthly expenses to your monthly income. By doing so, they will determine your debt-to-income ratio. It helps determine how much money you can afford to borrow.

Example:

Income from a job for one month	**$300**
Expenses	
Cell phone bill for one month	**$50**
Installment loan payment for computer	**$100**
Total Expenses	**$150**

Total expenses $150 / Total Income $300 = 50% debt to income ratio.

In most cases, lenders like to see a 36% or lower ratio before they loan money.

CAPITAL

Capital refers to the value of your assets and your net worth.

Lenders want to determine the value of your assets. Assets are things you own that have financial value. Lenders will also compare the difference between the value of your assets and the amount of debt you have. This is called net worth. A positive net worth demonstrates your ability to manage your money. Lenders will ask:

- How much money do you have in your checking and savings accounts?
- Do you have investments or other assets (e.g., a car)?

Typically an asset is something large like a house, a car, or a piece of large furniture. Smaller items such as household appliances and clothing are not considered assets.

An investment is when you have purchased an item or product that is expected to increase in value over time. Not all investments increase in value over time; you could even lose money.

CHARACTER

Character refers to how you have paid your bills or debts in the past. Lenders will ask:

- Have you had credit in the past?

If you have a good credit history of repaying your other loans, you will have an easier time getting your loan request approved and at the best rate. For instance, you can build a positive credit history by making your student loan payments on time.

- How many credit accounts do you have?

If you have never had a credit account, you may have difficulty getting approved for a loan. Having a good credit history shows a lender you can borrow money responsibly. Some lenders let you prove this without a credit history. For example, they might ask for proof that you pay your rent and utility and phone bills on time or that you make regular deposits to a savings account. Other examples of alternative ways to show a creditor that you are a good credit risk may include:

- Insurance premium payments.
- Payments for school tuition.
- Payments of personal loans (documented by a written loan agreement and canceled checks).

Ask the lender to consider alternative forms of history. If a lender is not willing to do this, shop around for one who will.

Banks will use credit reports to obtain character information. You can request a copy of your credit report by visiting *www.annualcreditreport.com* or calling 1-877-322-8228.

Collateral: Collateral refers to what you own that you can use to offer the lender in the event that you default on the loan. Lenders will ask:

- Do you have assets to provide to secure the loan beyond your capacity to pay it off?

Collateral is security you provide the lender. As we have seen, giving the lender collateral means that you pledge an asset that you own, such as your home, property you own, or other object that has value, to the lender with the agreement that it will be the repayment source in case you cannot repay the loan.

Sometimes a person with no credit history will ask another person to cosign a loan. The cosigner is equally responsible for repaying the loan. If the borrower defaults, the cosigner has to pay.

BARRIERS TO BORROWING MONEY

If a lender finds a history of being irresponsible, that tells the lender immediately that the borrower is a risk. Examples of the sort of past history a lender will be concerned about are:

- Consistently making late payments.
- Filing for bankruptcy.
- Having property repossessed or foreclosed on.
- Having a court order requiring a debtor to pay money to the creditor.

ACTIVITY 3: THE 4 C'S AND BARRIERS TO BORROWING MONEY

Lenders like to lend money to those who are going to pay them back.

Look at Activity 3 in the Course Activities section. Determine how a lender might look at a person's history.

LEGAL TERMS FOR TYPES OF DEBT ACTIONS

Bankruptcy — A legal declaration of insolvency. Bankruptcy will not fix credit record problems and will be part of your credit history for 10 years. You cannot necessarily walk away from your debts even with bankruptcy, as the law requires you to pay a portion of your unsecured debt if you are able to.

Foreclosure — A legal proceeding initiated by a creditor to take possession of collateral, for example a home that secured a defaulted loan.

Garnishment — A process by which a lender obtains directly from a third party, such as an employer, part of an employee's salary to satisfy an unpaid debt. Part of the employee's salary is taken each pay period until the debt is fully paid. This process must be authorized by a court order.

Judgment — A court order requiring a debtor to pay money to the creditor. The judgment places a security lien on the debtor's property until the judgment is satisfied (the debt is repaid).

Lien — A creditor's claim against property to secure repayment of a debt.

Repossession — Seizure of collateral that secured a loan in default.

Do you have any questions about the Four Cs of Credit Decision Making?

ACTIVITY 4: QUESTIONS TO ASK YOURSELF BEFORE APPLYING FOR CREDIT

Before you borrow money, there are some questions you should ask yourself.

Look at Activity 4 in the Course Activities section. List questions that you think you might ask yourself.

TIPS FOR MANAGING YOUR CREDIT

Once you have decided you want to get a loan and have been approved, you need to keep these tips in mind to use the money you have borrowed wisely.

- ✔ For a credit card, if possible, pay off your entire bill each month. If you cannot, try to pay more than the minimum balance due. This will reduce finance charges and total interest paid.
- ✔ If you can't pay off your credit card completely, stop using it. Do not allow yourself to get into more debt.
- ✔ Pay on time to avoid late fees and to protect your credit history. When the bill arrives, check the due date. It may be very soon. If you cannot pay on time, call your creditor immediately to explain the situation. The creditor may waive the late fees or be willing to make other payment arrangements. Always check your monthly statement to verify that it accurately lists the things you bought. Call your creditor right away if you suspect errors.
- ✔ Ignore offers creditors may send you to reduce or skip payments. You will still be charged finance charges during this period.
- ✔ Think about the cost difference if you purchase your item with cash versus if you purchase your item with credit.

PREDATORY LENDING PRACTICES

A predator in the animal kingdom is one that hunts and zeros in on its prey before capturing it for dinner. A predator in the lending arena is one who zeros in on certain potential customers using deceptive or unfair tactics in order to make them a customer, or charge them unfairly once they are a customer.

Predatory lending occurs when companies offer loan products using certain sales tactics or collection practices that are designed to frighten people, and loan terms that deceive borrowers. Predatory lending has become a serious problem.

Abusive practices can occur in any sort of lending. We are going to talk about two common ones. In *Charge It Right*, there is information about how credit cards can be abusive. It is also important to note that most of the problems are not caused by federally insured financial institutions.

SUBPRIME LENDING

Predatory lending often affects borrowers in the subprime market.

Subprime lending involves giving credit to borrowers whose credit history shows late payments, collections, bankruptcy, etc. These types of borrowers are considered to be higher risk.

Subprime lenders charge higher interest rates and loan fees to offset the higher costs associated with lending to borrowers with credit history problems.

Most predatory loans are made to subprime borrowers, but not all subprime loans are predatory. Subprime lending can be beneficial, if performed in a fair, reasonable, and legal manner. A subprime loan may be the only alternative available to some borrowers.

TWO TYPES OF PREDATORY LOANS

Two types of predatory loans that you should be aware of are:

- Predatory payday loans
- Predatory mortgage loans

PREDATORY PAYDAY LOANS

The first type of predatory loan is a payday loan made using predatory practices.

Payday loans are small cash advances, usually of $500 or less. To get a loan:

- A borrower gives a payday lender a postdated personal check or an authorization for automatic withdrawal from the borrower's bank account.
- In return, the borrower receives cash, minus the lender's fees.
- Assume you go to a payday lender and borrow $200.
- The payday lender will usually make a 2-week loan and might charge a fee of $30.
- You will write a postdated check to the lender for $230, dated after your next payday.
- The payday lender holds the check for 2 weeks.

When the loan is due, you can repay it by letting the lender cash the check, or you can give the lender the full amount due in cash.

The annual percentage rate for this transaction is 390 percent. An APR for a typical payday loan may be even higher than this example.

Most payday lenders allow you to "roll over" or renew your loan. The lender will charge an additional fee. In this case, you would write another postdated check, this time for $260 ($230 + $30 additional fee).

Remember that payday loans should only be used for emergencies. If you cannot fully repay the loan within a few pay periods, you should consider a longer term loan from a financial institution.

There are several signs that a payday loan may be a predatory loan. Let's find out what they are.

ACTIVITY 5: INDICATORS OF POSSIBLE PREDATORY PRACTICES

How do you know if a lender is being a predator?

Look at Activity 5 in the Course Activities section. Follow your instructor's directions.

Do you have any questions about how to spot a predatory practice?

CATCH PHRASES OF ABUSIVE LENDERS.

There are some catch phrases that should alert you to potential predatory practices. You may have already heard some of these in advertisements or seen them in mail, or on billboards. Beware when you hear…

"125 percent of your home/car's value"

- It can be dangerous to borrow more than your home or car is worth. If you stop making payments, you can lose your house or vehicle and still owe money.

"Incredibly low monthly payment"

- There is no disclosure as to how the lender intends to calculate monthly payments. There is a possibility the lender might have you pay only interest and not the principal, so you will never pay off the loan.

"No upfront fees"

- Be careful of loans that promise no upfront fees. This does not mean there are no fees. Many times, there are expensive fees added on to the cost of the loan and you will pay interest on these loan fees. This can be very costly. For example, if a $5,000 loan fee is added into the amount you borrow, you are paying $5,000 plus interest on the $5,000 over the life of the loan.

"Even if you have a bad credit history…"

- Beware of lenders who promise you loans even if you have a bad credit history. If you have a bad credit history, you will most likely pay higher interest rates and more expensive loan origination fees. All lenders take your credit history into account. Be aware that while some predatory lenders have been known to target low-income communities for high-cost, high-interest loans, no one is immune from their deceptive offers.

"It's free and you have nothing to lose"

- If it sounds too good to be true, it probably is. Even though the initial loan evaluation is free, there are other ways predatory lenders will take money from you. There might be hidden fees.

"Act now, this is a limited-time offer"

- Beware of "limited-time offers." Many predatory lenders try to pressure you into acting fast, even though you are not comfortable with the loan conditions.

THE TRUE COST OF ALTERNATIVE FINANCIAL SERVICES

Many lenders advertise "easy money." These types of loans are generally easier to obtain but also cost significantly more. Getting credit is not cheap. However, getting a bank loan is usually less expensive than other alternatives. We are going to look at two of these alternatives:

- Rent-to-own services
- Refund anticipation services

RENT-TO-OWN SERVICES

Rent-to-own services let you use an item for a period of time by making monthly or weekly payments. If you want to purchase the item, the store will set up a plan for you to rent it until you pay enough to own it. The store is the legal owner of the item until you make the final payment. If you miss a payment, the store can take the item back. If this happens, you will not own the item, and you will not get your money back. Rent-to-own agreements are technically not loans, so no interest is charged. However, the difference between the cash price and your total payment is like the interest you pay on a loan. Generally, using rent-to-own services is more expensive than getting a consumer installment loan to buy the item outright.

REFUND ANTICIPATION SERVICES

Refund anticipation loans are short-term loans secured by your expected income tax refund. Although the business preparing your income tax return will give you the money, you are actually receiving a loan from a bank or finance company. Because you do not have to pay any fees associated with obtaining a refund anticipation loan at the time you receive the money, you may not realize how much this loan is really costing you.

Example:

Your refund is $1,500.

- The fees associated with filing your income tax return with the tax preparation service and getting the refund anticipation loan equal $300.
- So, you will receive a check for $1,200. You are paying $300 in fees to obtain your income tax refund.

It is important to remember that the paperwork you sign to receive a refund anticipation loan will legally obligate you to repay a $1,500 loan. So, if your actual refund is only $800, you are responsible for repaying $700, plus interest to the lender that made the refund anticipation loan. And the higher the loan amount, the higher the refund anticipation loan fee.

Here are some typical costs associated with getting a refund anticipation loan.

Tax preparation fee	**$100**
Refund anticipation fee	**$75**
Electronic filing fee	**$40**
Document preparation	**$33**
Total Cost	**$248**

When you electronically file (e-file) your tax return and request direct deposit, your refund is often deposited in your bank account within two weeks. Sometimes refund anticipation loans take just as long, yet cost you substantially more money. Many organizations host Volunteer Income Tax Assistance (VITA) sites. VITA is an IRS-coordinated program that provides free income tax assistance and e-filing. Income eligibility restrictions apply. Contact the IRS for a location near you.

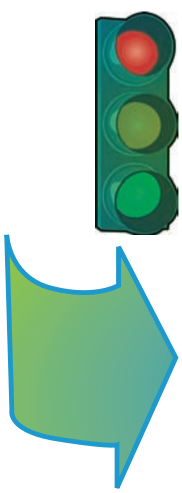
Do you have any questions about loan services to be wary of?

BE SMART! TIPS FOR BORROWING MONEY

If you are thinking about borrowing money, keep in mind these do's and don'ts.

DO:

- Pay your bills on time to build good credit history. Make sure your credit history is correct by reviewing your credit report every year.
- Be an informed customer. Make sure to shop around for the best deal. If a creditor is not willing to give you information to compare, you probably do not want to do business with him or her.
- Ask friends, family, and credit counselors for advice. Take someone along with you when you talk to a lender.
- Take your time before deciding on the best loan or lender.
- Be careful of lenders who tell you they do not care about your credit history or how much you earn. Many of these lenders charge higher interest rates and higher fees.



DON'T:

- Do not let lenders pressure you into a decision before you are ready.
- Do not respond to advertisements that make lending sound cheap and easy.
- Do not respond to offers to refinance your loan shortly after you just refinanced it. Make sure you really need the loan or the loan makes economic sense for you.

CHECKING YOUR BALANCE

SUMMARY

You have completed the *Borrowing Basics* module. We have covered a lot of information today about loans and credit. 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.

You should now be able to decide when and how to use credit.

Do you have any final questions?

KNOWLEDGE CHECK

1. CREDIT IS:

a. Money you borrow
b. A gift from the credit card company
c. The rate of a loan
d. Available only to people with savings accounts.

2. CREDIT IS IMPORTANT BECAUSE: (CIRCLE ALL THAT ARE TRUE.)

a. It can affect your ability to obtain employment, housing, and insurance depending on how you manage it.
b. It can be useful in times of emergencies.
c. If you don't have a credit report, you can't get a student loan.
d. It allows you to make a large purchase, such as a car or a house, and pay for it over time.

3. A HOME EQUITY LOAN:

a. Replaces a mortgage at a lower interest rate
b. Has the same monthly payment
c. Is a loan designed for purchasing a house
d. Can be used to pay for any kind of expense

4. AN INSTALLMENT LOAN:

a. Always has changing interest rates
b. Generally has the same payment every month
c. Can be used like a check
d. Is the same as rent-to-own agreements

5. WHICH OF THE FOLLOWING STATEMENTS IS THE MOST ACCURATE?

a. Lenders will only lend to people who have collateral.
b. Lenders are interested in knowing whether the borrower has a job and can make the loan payments.
c. Lenders want to know if the borrower has the capacity, capital, character and collateral to be creditworthy.
d. Lenders want to know if the borrower has the character and assets and savings to be creditworthy.

COURSE ACTIVITIES

ACTIVITY 1: TYPES OF LOANS

Read the description of the purchase to be made. Fill in the blank with the most appropriate loan type for that purchase.

TYPES OF LOANS

- Consumer installment loan
- Credit card
- Home loan (purchase, refinance or equity)

DESCRIPTION OF PURCHASE

1. To finance a college education.

____

2. To make small purchases in a department store, for example, a $50 household appliance.

____

3. To make home improvements.

____

4. To consolidate debts.

____

ACTIVITY 2: BORROWING MONEY RESPONSIBLY

Answer each of the following questions.

1. Would you use credit to pay overdue bills?

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2. Would you use credit to make a purchase even if you could pay cash?

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3. Would you use credit if you really wanted something but could not afford the monthly payment?

ACTIVITY 3: THE FOUR C's AND BARRIERS TO BORROWING MONEY

INSTRUCTIONS

Why are the items below barriers to borrowing money? Do they indicate a problem with capital, collateral, character and/or capacity? For each situation below, write whether the situation represents a problem with *capital*, *collateral*, *character* or *capacity*. It is possible to have more than one for any or all of the situations.

1. **Consistently making late payments…** Jeremy just got a cell phone. Jeremy needed the phone because he's out late on the weekends working part-time at the movie theater. He made payments on time, but had to quit his job because he had trouble in school and needed study time. His one-year contract requires him to still pay the monthly payment, but he hasn't paid it in three months.

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2. **Filing for bankruptcy…** Your older brother, who's in college, got too many credit cards at once and could not pay them. He had to file for bankruptcy, which creditors see as an inability to manage money, or pay bills.

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3. **Having property repossessed or foreclosed on…** Your uncle Joe bought a house, but he lost his job at the computer company and couldn't make mortgage payments any more. The bank foreclosed on his mortgage and took back the house.

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4. **Having a court order requiring a debtor to pay money to the creditor…** Sareta did not pay for repairs to her car, and the repair shop sued her in court for $876. On her credit report, the debt is listed as "Under Judgement" and "Unpaid".

ACTIVITY 4: QUESTIONS TO ASK YOURSELF BEFORE APPLYING FOR CREDIT

In the space below, make a list of questions you should ask yourself before applying for credit.

QUESTIONS:

ACTIVITY 5: INDICATORS OF POSSIBLE PREDATORY PRACTICES

PREDATORY PAYDAY LENDING

1. The company advertises terms that it does not actually offer.
2. You are not given disclosures listing terms, such as the finance charge and APR.
3. There is no "cooling off" or waiting period between the time you repay a payday loan and the time you are allowed to obtain another loan.
4. You can get a payday loan even if you currently owe payday loans to other companies at the same time.
5. You can obtain as many payday loans as you want each year.
6. You can get a payday loan to finance unpaid interest and fees.
7. The company threatens to prosecute you criminally for writing a bad check even though it knew you had insufficient funds in your account to pay the check and you paid it a payday loan fee.

INDICATORS OF PREDATORY MORTGAGE LENDING

1. **EXCESSIVE FEES**
   Points and fees are costs not directly reflected in interest rates. Because these costs can be financed, they are easy to disguise or downplay. On predatory loans, fees totaling more than 5 percent of the loan amount are common.
2. **ABUSIVE PREPAYMENT PENALTIES**
   Borrowers with higher interest subprime loans have a strong incentive to refinance as soon as their credit improves. However, most subprime mortgages carry a prepayment penalty – a fee for paying off a loan early. Be careful of prepayment penalties that last more than three years and/or cost more than six months' interest.
3. **KICKBACKS TO BROKERS**
   When brokers deliver a loan with an inflated interest rate (i.e., higher than the rate acceptable to the lender), the lender often pays the broker a fee known as a "yield spread premium." This payment makes the loan more costly to the borrower. You can avoid this by shopping around for the best rate.

4. LOAN FLIPPING

A lender "flips" a loan by refinancing it several times within a short time frame to generate fee income without providing any net tangible benefit to the borrower. Flipping can quickly drain borrower equity and increase monthly payments – sometimes on homes that had been previously owned free of debt.

5. UNNECESSARY PRODUCTS

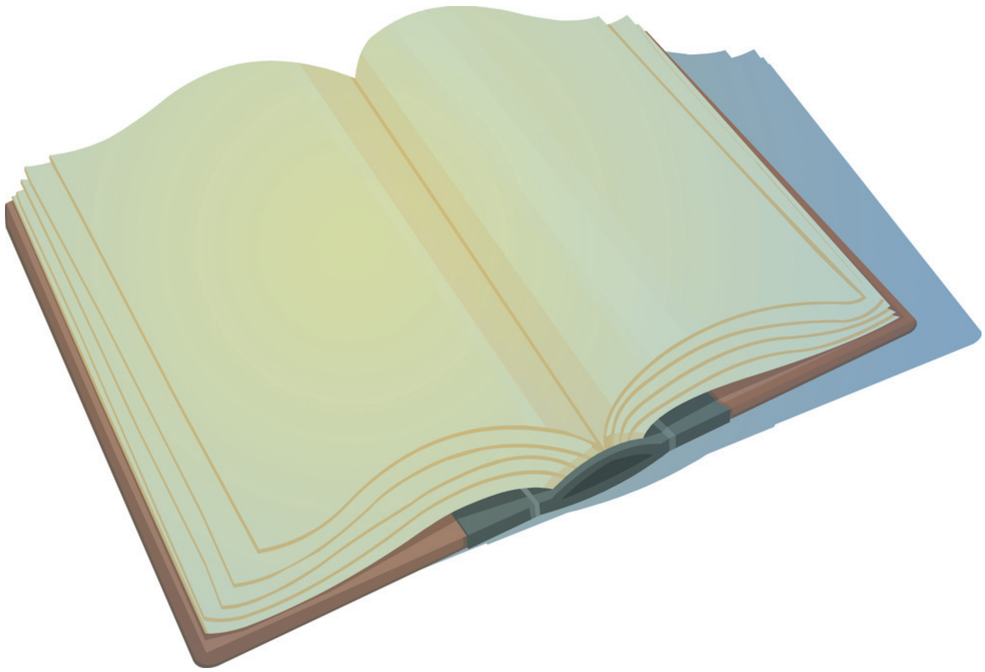
Sometimes borrowers may pay more than necessary because lenders sell and finance unnecessary insurance or other products along with the loan.

6. ASSET-BASED LENDING

Predatory lenders may approve a loan based on the value of a customer's equity in the home instead of his or her ability to repay the loan. The lender may later encourage the customer to default so the lender can get ownership of the home.

7. STEERING AND TARGETING

Predatory lenders may steer borrowers into subprime mortgages, even when the borrowers could qualify for a less expensive, typical loan. Vulnerable borrowers may face aggressive sales tactics and sometimes outright fraud.



GLOSSARY

ANNUAL PERCENTAGE RATE (APR)
The APR is the cost of your loan expressed as a yearly percentage rate. The law requires that the APR appear in 18-point font on most credit card applications so that it is easily seen.

ATTACHMENT
An attachment is a lien against personal property.

ASSET
An asset is something valuable that you own.

BANKRUPTCY
Bankruptcy is a legal declaration of insolvency. Bankruptcy will not fix credit record problems and will be part of your credit history for 10 years. A new law now requires that you get credit counseling before you can file for bankruptcy.

CAPACITY
Capacity refers to your present and future ability to meet your payments.

CAPITAL
Capital refers to the value of your assets and your net worth.

CHARACTER
Character refers to how you have paid your bills or debts in the past.

CONSUMER INSTALLMENT LOAN
A consumer installment loan is used to pay for personal expenses for you and your family. Examples are automobile loans and unsecured loans for short-term needs, such as buying a computer.

COLLATERAL
Collateral is security you provide the lender. Giving the lender collateral means that you pledge an asset that you own, such as your home, to the lender with the agreement that it will be the repayment source in case you cannot repay the loan.

CREDIT
Credit is money you borrow to pay for things. It is usually referred to as a loan. You make a promise to pay back the money you borrowed plus some extra. The extra amount is part of the cost of borrowing money.

EQUITY
Equity is the value of the home minus the debt, usually in the form of a home loan.

FEES
Fees are charged by financial institutions for activities such as reviewing your loan application and servicing the account.

FINANCE CHARGE
The total dollar amount the loan will cost you. It includes items such as interest, service charges, and loan fees.

FORECLOSURE
Foreclosure is a legal proceeding initiated by a creditor to take possession of collateral that secured a defaulted loan.

GARNISHMENT
Garnishment is a process granted by a court order by which a lender obtains directly from a third party, such as an employer, part of an employee's salary to satisfy an unpaid debt. Part of the employee's salary is taken out in each pay period until the debt is fully paid.

HOME EQUITY LOAN
Home equity loans are secured by a property of the borrower. The amount of equity is the value of the property minus the debt. Home equity loans generally can be used for any reason.

HOME PURCHASE LOANS
Home purchase loans are made for the purpose of buying a house. These loans are secured by the house you are buying.

HOME REFINANCE LOAN
Home refinancing is a process by which an existing home loan is paid off and replaced with a new loan.

INTEREST
Interest is the amount of money financial institutions charge for letting you use their money. The interest rate can be either fixed or variable. Fixed rate means the interest rate stays the same throughout the term of the loan. Variable rate means the interest rate might change during the loan term, as written in the loan contract.

JUDGMENT
A court order requiring a debtor to pay money to the creditor. The judgment places a security lien on the debtor's property until the judgment is satisfied (the debt is repaid).

LIEN
A lien is a creditor's claim against property to secure repayment of a debt.

PAY-DAY LOAN
Pay-day loans are usually made to people who need money right away and plan to pay it back with their next paycheck.

PENALTY APR
The terms of your credit card agreement may provide that the creditor will permanently increase the interest rate on your credit card by a large amount if you do not pay your credit card bill on time. This is called the penalty APR.

REFUND ANTICIPATION LOAN
Refund anticipation loans are short-term loans secured by your income tax refund. Although the business preparing your income tax return will give you the money, you are actually receiving a loan from a bank or finance company.

RENT-TO-OWN SERVICE
Rent-to-own services let you use an item for a period of time by making monthly or weekly payments. If you want to purchase the item, the store will set up a plan for you to rent it until you pay enough to own it.

REPOSSESSION
Repossession is the seizure of collateral that secured a loan in default.

UNIVERSAL DEFAULT
Your credit card interest rate can be raised to the highest possible rate if you are late on any other account. For example, if you have five credit cards and you are late on one, the interest rate for the other four cards may be increased by a large amount.

UNSECURED LOAN
An unsecured loan is not backed by collateral. Credit cards are examples of unsecured loans.

FOR FURTHER INFORMATION

FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC)

Division of Supervision &
Consumer Protection

2345 Grand Boulevard, Suite 1200
Kansas City, Missouri 64108

1-877-ASK-FDIC (1-877-275-3342)
Email: *consumer@fdic.gov*
www.fdic.gov

U.S. FINANCIAL LITERACY AND EDUCATION COMMISSION

www.mymoney.gov
1-888-My-Money (1-888-696-6639)

MyMoney.gov is the U.S. Government's website dedicated to teaching all Americans about financial education. Whether you are planning to buy a home, balancing your checkbook, or investing in your 401k, the resources on MyMoney.gov can help you.

Throughout the site, you will find important information from 20 Federal agencies.

FEDERAL CONSUMER INFORMATION CENTER (FCIC)

www.pueblo.gsa.gov
800-688-9889

The Federal Consumer Information Center (FCIC) provides free online consumer information to help the public. The FCIC produces the Consumer Action Handbook, which is designed to help citizens find the best sources for assistance with their consumer problems and questions.

USA.GOV: THE FEDERAL GOVERNMENT'S WEB PORTAL

www.usa.gov

FirstGov.gov is the official gateway to all government information.

CONSUMER.GOV: A RESOURCE FOR CONSUMER INFORMATION FROM THE FEDERAL GOVERNMENT

www.consumer.gov

DEPARTMENT OF EDUCATION

www.ed.gov/students

The Department of Education provides Information relating to college, financing, and student aid.

For other education-related resources:

- Complete the FAFSA online at *www.fafsa.ed.gov.*
- Find out more about scholarships at *www.ftc.gov/bcp/menus/consumer/education/scholarships.shtm*.
- For more information on Federal Loan Programs, *studentaid.ed.gov.*

FEDERAL TRADE COMMISSION

www.ftc.gov
877-FTC-HELP (382-4357)

The Federal Trade Commission website offers practical information on a variety of consumer topics, including credit and identity theft.

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT (HUD)

www.hud.gov
800-669-9777

The HUD website offers educational resources on buying and renting homes.

INTERNAL REVENUE SERVICE

www.irs.gov

You can get copies of IRS publications and forms at this website or by calling 800-829-3676. Call 800-829-1040 for questions about your income taxes.

SECURITIES AND EXCHANGE COMMISSION (SEC)

www.sec.gov
800-SEC-0330

The SEC provides information about investing.

SOCIAL SECURITY ADMINISTRATION

www.ssa.gov
800-772-1213

You can find out about Social Security benefits at this site.

GO DIRECT

www.GoDirect.org
(800) 333-1795

To quickly and easily sign up for direct deposit of your Social Security or other federal benefit payments, contact Go Direct, a campaign sponsored by the U.S. Department of the Treasury and the Federal Reserve Banks.

NATIONAL ASSOCIATION OF SECURITIES DEALERS

www.nasd.com
1-800-289-9999

The National Association of Securities Dealers provides information about registered securities brokers to help you decide whether to do business with them.

THE CENTER FOR SOCIAL DEVELOPMENT (CSD), GEORGE WARREN BROWN SCHOOL OF SOCIAL WORK, WASHINGTON UNIVERSITY, ST. LOUIS, MO.

gwbweb.wustl.edu/csd/asset/idas.htm

The CSD Website includes useful information on Individual Development Accounts (IDAs).