Participant Guide

BORROWING BASICS

FDIC Money Smart for Young Adults

Building: Knowledge, Security, Confidence

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Your Guides

Students from Lakeview High are going to be your guides in this lesson.

Jasmine

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

Todd

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

Ramón

Hobbies: Going to the movies or playing mini golf with his girlfriend
School life: Plays on the soccer team
Family: Born in the United States (U.S.), but his parents are from Peru; he has a little sister and an older brother who is a pilot in the Air Force
Job: Repairing computers; wants to work for NASA some day
Future plans: Attend college on a soccer scholarship to study engineering

Grace

Hobbies: Art, drawing fashion sketches
School life: Does not really fit into the "high school scene"
Family: Two parents, no siblings
Job: Works at a clothing store at the mall
Future plans: Enroll in Fashion Design School

Checking In

Welcome

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 how to 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.
- Explain why it is important to be wary of rent-to-own and refund anticipation services.

Student Materials

You have a copy of the *Borrowing Basics* Participant Guide. You can take it home and use it as a reference. It contains:

- Information and activities to help you learn the material
- Tools and instructions to complete the activities
- Checklists and tip sheets
- A glossary of the terms used in this module

Pre-Assessment

1. What is *credit*?
    a. Money you borrow and must pay back
    b. Free money that you do not have to pay back
    c. Money you have saved for emergencies
    d. The balance left on a gift card after you have used it to pay for something

2. Select all that apply. Maintaining good credit is important because it:
    a. Can help you graduate from college
    b. Allows you to carry more cash than usual
    c. Allows you to purchase large items like a car, house, or furniture and pay over time
    d. Might cause your interest rates to be raised

3. What is a *loan*?
    a. A charge by a financial institution for maintaining or servicing your loan account
    b. Money you borrow but must also repay
    c. Something valuable that you own and can sell for cash
    d. The cost of borrowing money

4. Which type of loan is used to pay for personal expenses for you and your family? Select all that apply.
    a. Consumer installment loans
    b. Credit cards
    c. Home loans

5. A loan for which of the following is most likely to be unsecured? Select all that apply.
    a. Home
    b. Car
    c. Furniture
    d. Education (e.g., student loan)

6. Which of the following replaces a loan on your home in order to get a better interest rate?
    a. Home equity loan
    b. Home equity line of credit
    c. Home refinance loan
    d. Home purchase loan

7. What type of an interest rate stays the same?
    a. Fixed rate
    b. Variable rate
    c. Waning interest
    d. Dual rate

8. What should you review and compare when shopping for a loan?
    a. Annual percentage rate (APR)
    b. Fees
    c. Truth in Lending Disclosures
    d. All of the above

9. What four factors do lenders generally use in their loan-making decision?
    a. Collateral, capacity, capital, and whether you purchase their credit protection insurance
    b. Capital, character, overdraft protection, and collateral
    c. Capacity, capital, collateral, and character
    d. Character, collateral, capacity, and credit limit

10. Getting credit is not cheap. However, which is usually the least expensive over time?
    a. Rent-to-own services
    b. Bank loan
    c. Payday loan
    d. Refund anticipation services

11. 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

12. If someone offers you a loan, what can you do to make sure it is a good deal?
    a. Check to make sure the loan provider is reputable
    b. Shop around and compare all terms and conditions
    c. Make sure you can afford the loan payments
    d. All of the above

13. Which of the following is a short-term loan secured by your expected income tax refund?
    a. Payday loans
    b. Rent-to-own services
    c. Refund anticipation services

14. The Equal Credit Opportunity Act (ECOA):
    a. Ensures you are not discriminated against (e.g., because of your race, color, or gender)
    b. Requires lenders to notify you if you are denied a loan or credit
    c. Requires creditors to promptly credit payments and correct billing mistakes

Borrowing Basics

Todd is excited about his new cell phone, but Ramón raised some good questions. What do you think about Todd's purchase?

Do you think Todd can afford his new purchase?

Is it wise for him to get a credit card so he can pay for the new cell phone?

What do you think might happen if Todd cannot pay his monthly cell phone or credit card bill? How might this affect his credit?

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. This cost is also called interest.

If you use credit carefully it can be useful to you. Not being careful in the way you use credit can cause problems.

Having "good credit" means that you 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. However, if you have problems using credit responsibly it will be harder to borrow money in the future.

Why Is Credit Important?

Credit is important because it:

- 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

Lenders take a risk to lend you money. Therefore, they want to be sure that their money is secure and they get repaid.

You will often hear loans referred to as either "unsecured," or as secured by *collateral* or *guarantee*. Credit is often secured.

Collateral is security you provide the lender.

- Example: You pledge an asset (something valuable that you own including a car, home, or savings account) to the lender with the agreement that it will be used as repayment if you cannot repay the loan.

Certain items, like the following, generally cannot be used as collateral unless they are used to secure the purchase of that item itself:

- Furniture for your home
- Clothing
- Kitchenware

A *guarantee* is a form of collateral.

- Example: If you do not qualify for a loan, you might ask someone to "cosign" the loan. That means that if you do not make the loan payments to the bank as agreed, the cosigner must pay the money you borrowed plus interest back to the bank.

A *secured loan* is one where you pledge collateral to repay the loan. Home equity loans and loans to purchase a car are two common examples.

An *unsecured loan* is not backed by collateral.

- Example: Personal and student loans and credit cards (although some credit cards are secured)

Types of Loans

Credit Cards

Credit cards give you the ongoing ability to borrow money for household, family, and other personal expenses.

Having a credit card allows you to buy things without actually having the money right away. Remember that if you are not careful in spending you can get into big trouble—you could be burdened with debt. You need to be sure you are able to make at least the minimum monthly payment on your credit card bill. Ideally, though, you will pay your bill in full each month to avoid paying costly interest to the lender.

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. One of the more common types of installment loans is a loan to purchase a car. A student loan is also repaid in installments over time.

Cheaper Than Alternatives

When you need to borrow money for a larger purchase, there are certain advantages of borrowing through an installment loan instead of through a credit card or rent-to-own service:

- You are aware of the monthly payment amount and the time period given to pay off the loan.
- Installment loans, especially when secured by collateral, generally have much lower rates so it costs you less to borrow money.
- Repaying an installment loan includes principal and interest according to a preset payment schedule. This reduces the original loan balance during the term of the loan.

Activity 1: Consumer Installment Loan versus Rent-to-Own Services

Although there are many similarities between secured installment loans and rent-to-own services.

Consumer Installment Loans	Rent-to-Own Services
• Secured installment loans are loans that are repaid in equal monthly payments for a specific period and are secured by the item you purchased. You can use the item you purchased while you are paying.	• Rent-to-own services allow you to use an item while you make weekly or monthly payments. • When renting or leasing the item, you do not have to purchase the item and can return it at the end of the rental period or before you make your next weekly payment. You will not receive a refund of money paid. • If you decide to purchase the item, the store may give you a price to buy the item or set up a plan to apply weekly rental payments toward the purchase price. • The store is the legal owner until you make the final payment. If you miss a payment the store may repossess the property, which means they take the property back from you.
• With installment loans, you are charged interest and you can shop for the best deal by comparing APRs.	• Rent-to-own agreements are technically not loans, so no interest is charged and, often, no credit check is performed. • However, the fees included in your rental payment are just like the interest you would pay on a loan.
• Generally, installment loans are less expensive than rent-to-own agreements.	• By making the weekly payments, you will pay much more than if you paid cash or used an installment loan.

Scenario

Grace is moving into her own apartment after graduation and wants to buy a television. She is trying to decide between getting an installment loan and using a rent-to-own service for the large purchase. A local electronics store was selling the television for $1,500.00. A nearby rent-to-own store advertised the same model for $55.00 every other week. After seeing the advertisement, Grace went to the rent-to-own store to get more details. The manager told Grace she would own the television in 52 payments or 2 years. Grace multiplied $55.00 x 52 weeks and got $2,860.00. Grace also found out that if she misses one payment, the rent-to-own service will take the television back. If she makes 50 payments on time (i.e.., 50 x $55.00 = $2,750.00) and misses payment 51, she loses the television and is out $2,750.00.

The manager told Grace that with rent-to-own services, she could return the television with no obligation. Grace did another quick calculation. If she used the rent-to-own company and returned the television after a year, she would pay $1,430.00 (26 weeks x $55.00).

Help Grace decide which option is better: to use a rent-to-own service or to apply for an installment loan.

Consumer Installment Loan	Rent-to-Own
Advertised price = $1,500.00 12 percent APR for 2 years $70.61 x 24 months = $1,695.00 *Grace saved $1,165.00.*	Advertised price = $55.00 every other week (hidden costs) $55.00 x 52 weeks = $2,860.00

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. Homeowners often refinance their home loans for a lower interest rate or to obtain money for home repairs or other personal needs.

Home equity loans can be used for any reason (e.g., remodeling, education, or other large purchases). The amount that a person can borrow depends on the amount of equity they have in the house. In general, the best uses for home equity loans are to purchase goods or services with long-term benefits, such as home improvements that add to the value of your property. The riskiest uses of home equity loans include a vacation because you could end up paying a lot in interest charges for a purchase that is only of short-term value.

Activity 2: 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. Note: there may be more than one correct answer.

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 (e.g., a $50.00 household appliance)

   ____

3. To make large home improvements

   ____

4. To consolidate debts

   ____

The Cost of Credit

Fees

Fees are charged by financial institutions for activities including, reviewing your loan application and servicing the account. Examples:

- A credit card company might charge you an annual fee of $30.00.
- A credit card company may also charge you a service fee for cash advances or a penalty fee if 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 $30.00 late fee when you do not pay your bill on time.

Interest

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

- *Fixed rates* stay the same throughout the term of the loan, except in the case of credit cards. With credit cards, the rate may be changed if the bank gives you required notice.
- *Variable rates* might change during the loan term. The loan agreement will show the details of the rate changes.

Truth in Lending Disclosures

The Federal Truth in Lending Act requires banks to state charges in a clear and uniform manner so you can compare the actual cost of borrowing. This law allows you to comparison shop between lenders for credit cards and other loans.

What Lenders Must Disclose

For a closed-end loan (e.g., when you borrow a set amount of money to purchase a car) lenders are required by law to disclose:

- **The amount financed:** the amount of the loan the lender is letting you borrow (e.g., $5,000.00 for 1 year).
- **Annual Percentage Rate (APR):** the cost of your loan expressed as a yearly percentage rate (e.g., 12 percent). 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 must be easily seen on credit card applications.

  - The *penalty APR* is the APR charged on new credit card transactions if you trigger the penalty terms in your credit card contract. Your credit card issuer may consider you in default if you pay late, go over your credit limit, or if your check is returned. If you become more than 60 days late, the penalty APR may be applied to your existing balance.
- **Finance charges:** fees charged as a cost of borrowing money. These charges may include interest, service charges, and loan fees. For example, if the finance charges on the $5,000.00 loan are equal 12 percent, the total finance charges would be $600.00.
- **The total payment:** the amount you will have paid after making all scheduled payments. Using the $5,000.00 loan as an example, the total payment including the original amount borrowed, plus the interest, is $5,600.00 for 1 year. If the length of the loan is longer, the monthly payments will be lower. However, you will end up paying more interest in the end.

Activity 3: Borrowing Money Responsibly

Answer each of the following questions. Be prepared to explain your answer.

1. What questions should you ask yourself before you decide to apply for credit?

   ____
   ____
   ____

2. Would you use credit to pay overdue bills? Why?

   ____
   ____
   ____

3. If you are trying to establish a credit history, would you use credit to make a purchase even if you could pay cash? Why?

   ____
   ____
   ____

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

Equal Credit Opportunity Act

The Equal Credit Opportunity Act (ECOA) ensures that all **creditworthy** applicants are given an equal chance to obtain credit. This act:

- Prohibits lenders from discriminating against you because of your race, color, marital status, religion, national origin, sex, age, or receipt of public assistance when deciding whether to issue you a loan.
- Restricts lenders from requesting certain information during the loan application process.
- Requires the lender to notify you in writing, within 30 days of the date of the loan application, if you have been approved or denied the 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
Capacity refers to your present and future ability to meet your payments. Lenders may ask:

- Do you have a job?
- How much money do you make each month?
- What are your monthly expenses?

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

A bank will compare the amount you owe and your other monthly expenses with your monthly income. This is called a debt-to-income ratio. It helps determine how much money you can afford to borrow. The bank wants to ensure that your expenses are not too high for you to take on the additional monthly debt of a loan payment. They want to be sure you can repay what they lend. In most cases, lenders prefer that you have a debt-to-income ratio that is 36 percent or lower.

Capital

Capital refers to the value of your assets and your net worth. Lenders want to determine the value of your assets (i.e., 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.

Questions lenders may ask include:

- 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

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

- 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?

Banks will use credit reports to obtain character information. You can obtain free annual credit reports by doing one of the following:

- Submit a request online at www.annualcreditreport.com
- Call toll-free: **1-877-322-8228**
- Complete the Annual Credit Report Request Form from
- www.annualcreditreport.com or www.ftc.gov/credit and mail it to:

  Annual Credit Report Request Service
  P.O. Box 105281
  Atlanta, GA 30348-5281

If you have a good credit history of repaying your other loans, you will have an easier time getting your loan request approved.
Having a good credit history shows a lender you can borrow money responsibly.

If you have never had a credit account, you may have difficulty getting approved for a loan. Some lenders may let you prove your creditworthiness by asking for proof that you pay your rent and bills (e.g., utility and phone bills, insurance payments, school tuition, and personal loan payments) on time, or that you make regular deposits to a savings account. Ask the lender to consider alternative forms of history. If a lender is not willing to do this, shop around for one who will.

Collateral
Collateral refers to property or assets you can offer to secure the loan. Lenders may ask:

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

Collateral is security you provide the lender. Giving the lender collateral means that you pledge an asset that you own (e.g., a car) 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 (i.e., cannot make the payments), the cosigner has to pay.

Barriers to Borrowing Money

If a lender finds you have a poor credit history, that tells the lender immediately that you are a risk and they may not be willing to lend you money. As you start to develop a credit history, be sure to avoid:

- 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 Types of Debt Actions

- **Attachment:** A lien against personal property.
- **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 must get credit counseling before you can file for bankruptcy. If possible, the law also requires you to pay a portion of your unsecured debt.
- **Collection account:** A past-due account that has been referred to a specialist to collect part or all of the debt (e.g., if you do not pay your bills, after a period of time, the creditor may ask a collection agency to collect the amount you owe).
- **Foreclosure:** A legal proceeding initiated by a lender to take possession of collateral that secured a defaulted loan.
- **Garnishment:** A process by which a lender obtains directly from a third party (e.g., 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 lender. The judgment places a security lien on the debtor's property until the judgment is satisfied (the debt is repaid).
- **Lien:** A lender's claim against property to secure repayment of a debt.
- **Repossession:** Seizure of collateral that secured a loan in default.

Activity 4: Borrowing Barriers

Reach each scenario. Indicate which of the Four Cs are affected by each of the barriers to borrowing money: Capital, Collateral, Character, and/or Capacity. There may be more than one correct answer.

1. Consistently making late payments: Jeremy bought a cell phone because he works late at the movie theater on the weekends. At first, he made all of his payments on time. However, he had to quit his job because he had trouble in school and needed more time to study. He signed a 1-year contract and is having difficulty making payments.

He has made late payments for the past 3 months.

2. Filing for bankruptcy: Jeremy's older brother, who is in college, applied for and received several credit cards. He maxed out (met his credit limit on) all of the credit cards, and then he could not afford to make the payments. He filed for bankruptcy, which shows lenders his inability to manage money and pay bills.

3. Not enough assets: Joe wants to buy a house. He has a job, and the house will be collateral for the loan. However, Joe does not have enough money in his checking and savings account to reassure the lender that after closing he will have enough funds to make a payment or home repair in an emergency.

4. No credit history: Sareta wants to apply for a credit card. She is in college and does not have a regular income. She also has no credit history. Therefore, she will need to ask her mother or father to cosign the loan.

Activity 5: Loan Applications

Lenders are able to gather information related to the Four Cs by requiring you to complete a credit or loan application. They will review this information and additional sources of information (e.g., your credit report) before they determine whether to grant you the loan.

Application questions and requirements may vary according to loan type (e.g., credit card, installment loans, home loans, and student loans) and by financial institution.

The following information is taken from the Uniform Residential Loan Application, which is the standard form used for mortgage loan applications. The questions are similar to applications for other types of loans. Review each section of the form on the following pages. Match the required information with the appropriate C: Capital, Collateral, Character, and/or Capacity. There may be more than one correct answer.

1. Employment Information: ____

Name & Address of Employer ☐ Self Employed		Dates (from – to)
		Monthly Income $
Position/Title/Type of Business	Business Phone (incl. area code)	
Name & Address of Employer ☐ Self Employed		Dates (from – to)
		Monthly Income $
Position/Title/Type of Business	Business Phone (incl. area code)	

2. Monthly Income and Combined Housing Expense Information:

____

Gross Monthly Income	Borrower	Co-Borrower	Total
Base Empl. Income*	$	$	$
Overtime			
Bonuses			
Commissions			
Dividends/Interest			
Net Rental Income			
Other (before completing, see the notice in "describe other income," below)			
Total	$	$	$

Combined Monthly Housing Expense	Present	Proposed
Rent	$	
First Mortgage (P&I)		$
Other Financing (P&I)		
Hazard Insurance		
Real Estate Taxes		
Mortgage Insurance		
Homeowner Assn. Dues		
Other:		
Total	$	$

3. Declarations: ____

VIII. DECLARATIONS				
If you answer "Yes" to any questions a through i, please use continuation sheet for explanation.	**Borrower**		**Co-Borrower**	
	Yes	**No**	**Yes**	**No**
a. Are there any outstanding judgments against you?	☐	☐	☐	☐
b. Have you been declared bankrupt within the past 7 years?	☐	☐	☐	☐
c. Have you had property foreclosed upon or given title or deed in lieu thereof in the last 7 years?	☐	☐	☐	☐
d. Are you a party to a lawsuit?	☐	☐	☐	☐
e. Have you directly or indirectly been obligated on any loan which resulted in foreclosure, transfer of title in lieu of foreclosure, or judgment?	☐	☐	☐	☐
(This would include such loans as home mortgage loans, SBA loans, home improvement loans, educational loans, manufactured (mobile) home loans, any mortgage, financial obligation, bond, or loan guarantee. If "Yes," provide details, including date, name, and address of Lender, FHA or VA case number, if any, and reasons for the action.)				

4. Assets (e.g., checking and savings account, investment products, and car) and Liabilities (e.g., automobile or other loans, charge accounts, and other forms of debt):

____

ASSETS Description	Cash or Market Value	Liabilities and Pledged Assets. List the creditor's name, address, and account number for all outstanding debts, including automobile loans, revolving charge accounts, real estate loans, alimony, child support, stock pledges, etc. Use continuation sheet, if necessary. Indicate by (*) those liabilities, which will be satisfied upon sale of real estate owned or upon refinancing of the subject property.		
Cash deposit toward purchase held by:	$			
List checking and savings accounts below		LIABILITIES	Monthly Payment & Months Left to Pay	Unpaid Balance
Name and address of Bank, S&L, or Credit Union		Name and address of Company	$ Payment/Months	$
Acct. no.	$	Acct. no.		
Name and address of Bank, S&L, or Credit Union		Name and address of Company	$ Payment/Months	$
Acct. no.	$	Acct. no.		
Name and address of Bank, S&L, or Credit Union		Name and address of Company	$ Payment/Months	$
Acct. no.	$	Acct. no.		

Credit Report

A credit report helps lenders make their decision when deciding whether to extend or give you credit. A credit report is a record of how you have paid your debts. It 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

There are three major credit reporting agencies:

- Equifax
- Experian
- TransUnion

These agencies:

- Receive information from lenders, usually monthly, about whether you are making loan and credit card payments on time
- Collect information about bankruptcy filings, court-ordered judgments, tax liens, and other public record information from courthouse records

While each credit reporting agency may have a different format for its credit report, the type of information they contain is basically the same and includes:

1. Personal or consumer information (e.g., name, addresses, and employment)
2. Personal or consumer statement, if you submit a statement to the credit reporting agencies to be included in your credit report
3. Account summary, including: creditor information, account status and type, and account history
4. Inquiries that have been made into your credit history
5. Public record information (tax lien, legal item, bankruptcy, wage item, judgment, etc.); not shown

JOHN Q CONSUMER **Report** #1234567	**Report Date** 01/01/2006
Personal Information 1 123 Main Street #2 Somewhereville, USA 01234 **SSN**#123-45-6789 **DOB** 02/01/68	**Employers** 1. ABCDE Enginering Corp, Somewheresville USA 2. Port City Engineering, Anywhere, USA
Consumer Statement No personal statements appear in your report. 2	
Potentially Negative Items **Televise Cable Comm.** **Acct#:** 1234 5678 1234 5678 **Type:** Collections **Date filed:** 05/01/05 **Status:** Delinquent in collections 120+days **Amount:** $125.00 **Credit limit/Original Amount:** N/A 3	
Accounts in Good Standing **XYZ BANKCARD USA** **Acct#:** 0110220 **Type:** Revolving **Date added:** 12/12/99 **Responsibility:** Individual **Status:** Open/Never late **Monthly Payment:** $15 **Terms:** N/A **High balance:** $129 **Credit Limit/Original Amount:** $1000 **Recent Balance:** $79	**Automobile Financing Services** **Acct#:** 0981024057 **Type:** Installment **Date added:** 03/29/06 **Responsibility:** Individual **Status:** Open/Never late **Monthly Payment:** $245 **Terms:** 60 months **High balance:** N/A **Credit Limit/Original Amount:** $10,000 **Recent Balance:** $4,665
Requests for Credit History **VISA Card** 4 **Address:** PO Box 1414 NY NY 10001 **Date:** 04/01/05	

Activity 6: John Q. Consumer

Use the sample credit report to answer the questions about John's credit history.

JOHN Q CONSUMER **Report** #1234567	**Report Date** 01/01/2006
Personal Information 123 Main Street #2 Somewheresville, USA 01234 **SSN**#123-45-6789 **DOB** 02/01/68	**Employers** 1. ABCDE Engineering Corp, Somewheresville, USA 2. Port City Engineering, Anywhere, USA
Potentially Negative Items **Televise Cable Comm.** **Acct#:** 1234 5678 1234 5678 **Date filed:** 05/01/05 **Status:** Delinquent in collections 120+ days	

Amount: $35.00 **Credit limit:** N/A	
Accounts in Good Standing **XYZ BANKCARD USA** **Acct#** 0110220 **Date added** 12/12/98 **Status**: Open/Never late **Monthly Payment** $15.00 **High balance** $129.00 **Credit Limit** $1,000.00	**Homeowner Credit Services** **Acct#** 0110220 **Date added** 04/23/00 **Status**: Closed at consumer's request 08/22/2004 **Monthly Payment** $0 **High balance** $3,228.00 **Credit Limit** $1,000.00
Requests for Credit History **VISA Card** **Address:** PO Box 1414 NY, NY 10001 **Date:** 04/01/05	

1. John Consumer has an account that has been sent to a collection agency. Where on his credit report would you find this information?

   ____

2. Who is the original creditor?

   ____

3. In August 2004, an account was closed at John's request. What was the high balance on this account? ______________________
4. Where did you find this information?

   ____

5. Who does John work for? Where did you find this information? Hint: current employers are listed first.

   ____

Tips for Building Your Credit

To build your credit history or demonstrate your creditworthiness:

- Make regular deposits into a savings account. Ask the lender to consider this as proof that you can make payments every month, even if you are making the payments to yourself. Also, ask the lender to review your history of making rent and utility payments to demonstrate your ability to pay.
- Pay all of your bills on time. This will help establish a good credit history so you can get credit in the future. Not paying any bill you receive (e.g., cell phone bills, medical bills, or parking tickets) can

harm your credit. If you are not responsible for the bill, do not ignore it. Contact the company that sent you the bill (or others if necessary—e.g., bank, credit card company, or credit reporting agency) to resolve the issue and ensure it does not affect your credit.

- Apply for a small loan at the bank or credit union where you have checking and savings accounts. Also, consider asking the financial institution to loan you money secured by funds in a savings account or a certificate of deposit. This reduces the lender's risk, but it enables you to show that you can make timely payments on a loan.
- Apply for credit with a local store. They typically have a lower credit limit and a higher APR, but they are generally more willing to lend you money.
- Make a large down payment on a purchase and negotiate credit payments for the balance. If you do not have a credit history but have a large down payment, there is less risk to the lender that you will not make the payments. For example, if you are buying a used car for $5,000.00 and have enough cash, you might consider making a down payment of $1,000.00 to $3,000.00. Although the loan will be very small, it can prove you make your payments on time.
- Ask a friend or relative with an established credit history to be a cosigner for you. A cosigner promises to repay the loan if you do not. The lender should report the payment information for both you and the cosigner to the credit reporting agencies. Remember that you can damage the cosigner's credit history if you do not pay the loan back as promised.
- Keep your debt levels low. The more debt you have in relation to your income or your available credit lines, the more you will be viewed by lenders as a higher risk borrower. All of your monthly obligations (e.g., rent/mortgage, car payments, school loans, credit card payments, etc.) should be less than or equal to 33 to 36 percent of your monthly gross income.
- Consider a no- or low-fee secured credit card if you cannot qualify for a regular credit card. Secured credit cards require you to keep cash (that serves as collateral) in a deposit account. Your credit limit would be based on the amount of cash you have in the deposit account.

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:

- Pay off your entire credit card bill each month if possible. Try to pay more than the minimum balance due if you cannot. This will reduce finance charges and total interest paid. You may also want to stop using your credit card until you can pay off the balance so you do not accrue more debt than you can afford.
- Pay your credit card or loan payments on time to avoid late fees and protect your credit history. 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

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 the 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 $5,000.00 loan fee is added into the amount you borrow, you are paying $5,000.00 plus interest on the $5,000.00 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 may 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 is 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.

Guard Against Predatory Lending Practices

The best ways to guard against predatory lending practices is to:

- Deal with reputable loan providers
- Shop around with several loan providers of your choice to obtain the best terms
- Read and understand all terms and conditions of an offered loan or ask questions until you are sure you understand
- Ensure you can afford and make payments according to the loan terms

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 three of these alternatives:

- Rent-to-own services
- Payday loans
- Refund anticipation loans

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 similar to 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.

Payday Loans

Payday loans are short-term loans (usually up to 2 weeks). You write a post-dated check and receive cash that day. The loan service cashes the check on your payday to pay the loan in full. You can also go into the loan office and pay your loan with cash, at which point the lender returns your check to you.

You must be careful of payday loans. They are usually made to people who need money right away and who plan to pay it back with their next paycheck. However, if unable or unwilling to repay the loan when it is due, many people pay more fees to get another payday loan.

Payday loans can be much more costly than they appear at first glance. If you do not have the money to pay the loan within the agreed-upon time period, the lender may renew the loan and charge you additional fees. This will increase the total amount you owe.

Refund Anticipation Loans

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. You do not have to pay any fees associated with obtaining a refund anticipation loan at the time you receive the money. Therefore, you may not realize how much this loan is really costing you.

Be Smart! Tips for Borrowing Money

If you are thinking about borrowing money, keep in mind the following guidelines.

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.

Do Not:

- Let lenders pressure you into a decision before you are ready.
- Respond to advertisements that make lending sound cheap and easy.
- 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.

Module Summary

Congratulations! 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.

Knowledge Check

1. If you buy something on credit, you must pay back the amount you borrowed:
   a. All at once
   b. Plus interest
   c. According to the credit terms
   d. b and c

2. A loan is the amount of money a financial institution charges for allowing you to use its money.
   a. True
   b. False

3. The three main types of loans are:
   a. Consumer installment loans
   b. Credit cards
   c. Home loans
   d. All of the above

4. What is used as collateral for a home loan?
   a. The home
   b. The furniture or furnishings
   c. Personal assets (e.g., a car)
   d. All of the above

5. Which of the following is an example of a secured loan?
   a. Home loans and home equity loans
   b. Most credit cards
   c. Personal loans
   d. Student loans

6. Which type of interest rate can change during the loan term?
   a. Fixed interest rate
   b. Variable interest rate

7. Which of the following must be included in the Truth in Lending Disclosure?
    a. Amount financed
    b. APR
    c. Finance charge
    d. Total payments
    e. All of the above

8. Lenders will review the Four Cs to determine whether you are a good credit risk. Which of the following refers to property or assets offered to secure the loan?
    a. Capacity
    b. Collateral
    c. Capital
    d. Character

9. Which of the following information is included in your credit report? Select all that apply.
    a. A list of inquiries for your credit report
    b. Personal identifying information
    c. Credit history of your accounts
    d. Public record information
    e. All of the above

10. You must be careful of rent-to-own services, payday loans, and refund anticipation loans because they often cost more than an installment loan.
    a. True
    b. False

11. 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

12. Why is credit important?
    a. It allows you to make a large purchase (e.g., a car or house) and pay for it over time
    b. It can be useful in times of emergencies
    c. It is more convenient and safer than carrying large amounts of cash
    d. All of the above

13. Which of the following let you use an item for a period of time by making monthly or weekly payments?
    a. Payday loans
    b. Rent-to-own services
    c. Refund anticipation services

14. Which act ensures you are not discriminated against because of your race, color, or gender?
    a. The Equal Credit Opportunity Act (ECOA)
    b. The Fair Credit Reporting Act (FCRA)
    c. The Truth in Lending Act
    d. All of the above

Glossary

Annual Percentage Rate (APR): The cost of your loan expressed as a yearly percentage rate.

Attachment: An attachment is a lien against personal property.

Asset: An asset is something valuable that you own.

Bankruptcy: A legal declaration of insolvency. Bankruptcy will not fix credit report 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.

Credit: The ability to borrow money.

Collateral: The security you provide the lender.

Capacity: Your present and future ability to meet your payments.

Capital: The value of your assets and your net worth.

Character: Proof of how you have paid your bills or debts in the past.

Consumer Installment Loan: A loan used to pay for personal expenses for you and your family over a set term or period of time.

Credit Cards: Plastic cards with magnetic strips on the back. The front displays your account number, name, and bank name. With a credit card, you can buy goods or services and pay for them over time, receiving a bill each month. Credit cards give you the ongoing ability to borrow money for household, family, and other personal expenses.

Fees: The amounts charged by financial institutions for activities like reviewing your loan application and servicing the account.

Finance Charge: The total dollar amount the loan will cost you. It includes items like interest, service charges, and loan fees.

Fixed Rate: The interest rate stays the same throughout the term of the loan, except in the case of credit cards where the rate may be changed.

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

Garnishment: A process granted by a court order by which a lender obtains directly from a third party (e.g., 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.

Guarantee: A form of collateral. It occurs when someone you know agrees to be responsible for any money that you owe the lender but have not paid.

Home Equity Loan: A loan that allows a homeowner to borrow money that is secured by their home.

Home Purchase Loan: A loan for the purpose of buying a house. This loan is secured by the house you are buying.

Home Refinancing Loan: A loan process by which an existing home loan is paid off and replaced with a new loan.

Interest: The amount of money a financial institution charges for letting you use its money.

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.

Loan: Money borrowed on credit.

Payday Loan: A short-term loan. The loan service cashes the check on your payday, at which time your loan is paid in full.

Penalty Annual Percentage Rate (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.

Predatory Lending: Use of certain marketing tactics in making loans (e.g., abusive collection tactics and loan terms that deceive borrowers into thinking they are receiving better loan terms than they really are).

Refund Anticipation Loans: Short-term loans secured by your income tax refund.

Rent-to-Own Service: A service that lets you use an item for a period of time by making monthly or weekly payments. You can opt to purchase the item(s) you are renting, but it is usually much more expensive than purchasing the item (s) outright.

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

Unsecured Loan: A loan not backed by collateral. Credit cards are often unsecured loans, although some are secured by a bank account.

Variable rate: An interest rate that may change during the loan term.

For Further Information

Federal Deposit Insurance Corporation (FDIC)

www.fdic.gov/consumer

1-877-ASK-FDIC (275-3342)

Visit the FDIC's website for additional information and resources on consumer issues. For example, every issue of the quarterly *FDIC Consumer News* provides practical hints and guidance on how to become a smarter, safer user of financial services. Also, the FDIC's Consumer Response Center is responsible for:

- Investigating all types of consumer complaints about FDIC-supervised institutions
- Responding to consumer inquiries about consumer laws and regulations and banking practices

U.S. Financial Literacy and Education Commission

www.mymoney.gov

1-888-My-Money (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, balance your checkbook, or invest in your 401k the resources on MyMoney.gov can help you. Throughout the site you will find important information from federal agencies.

Federal Consumer Information Center

www.pueblo.gsa.gov

1-800-688-9889

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.