PERSONAL FINANCE

Credit, Lending, & Debt

By Dr. Mike Casey, Professor of Finance, University of Central Arkansas

ARKANSAS CENTER FOR RESEARCH IN ECONOMICS
UNIVERSITY OF CENTRAL ARKANSAS

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About ACRE

The Arkansas Center for Research in Economics is an Arkansas-focused research center housed in the College of Business at the University of Central Arkansas. Our scholars and policy analysts use academic research and original analysis to educate the public on important issues of public policy in Arkansas. Our research focuses on barriers to employment, taxes and subsidies, K–12 education, property rights, and government transparency. The views expressed in this publication do not necessarily reflect those of the University of Central Arkansas.

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Pacing Guide

This module covers a lot of information and should be split into several days. It can be extended beyond four days by using additional recommended resources. The following guide is a suggestion about how to sequence the material.

Suggested Pacing Guide

01 DAY

Topic: Understanding Credit and Why It's Important to You Now

PFM.9.E.1: Evaluate costs and benefits (e.g., interest rates, fees, penalties, rewards) of using various types of credit: student loans, credit cards, personal loans (e.g., auto, home mortgage)

PF.4.C.5: Understand different components of credit by: Comparing and contrasting sources of credit (e.g., car loans, student loans, credit cards,) Discussing the establishment and use of credit, Identifying the factors that contribute to a credit score, Calculating the actual costs associated with credit, Discussing methods of solving credit problems, Evaluating the risks associated with overextending credit

Essential Question: What is credit and how do I use it? How do I afford big ticket items?
Activity: When Do I Borrow Money?

02 DAY

Topic: Credit Reports, Credit Scores, and How Credit Can Help or Harm You

PFM.9.E.2: Analyze factors that affect credit worthiness (e.g., credit score, three Cs of credit)

PF.4.C.4: Analyze factors that determine/influence mortgage costs (e.g., interest rate, term length, credit rating)

Essential Question: What makes a credit score "good" or "bad?" How do my spending decisions affect my credit score?
Activity: Would You Loan Me Money?

03 DAY

Topic: Understanding Loans

PF.4.C.3: Compare and contrast the advantages and disadvantages of renting versus owning a home (e.g., costs, taxes, insurance)

PF.4.C.7: Understand the different components of loans by: Differentiating between the different types of loans (e.g., payday, auto, home, personal, student,) Examining the lending process from application to approval, Calculating true costs associated with loans (e.g., term length, interest rate,) Understanding the factors that contribute to different interest rates, Evaluating the implications of obtaining and/or defaulting on a loan

Essential Questions: Under what circumstances should I take out a loan? How long does it take to pay back a loan?
Activity: Should You Rent or Buy

04 DAY

Topic: Your Credit: Protection and Problem Solving

PFM.9.E.3: Evaluate strategies to avoid and correct credit issues: identity protection, bankruptcy, debt and credit management

PF.4.C.1: Identify types of fraud and credit abuse and develop strategies to protect oneself from identity fraud and theft

PFM.9.E.4: Discuss consumer protection laws (e.g., Credit Card Accountability, Responsibility and Disclosure Act of 2009, Truth in Lending Act, Fair Debt Collection Practices Act, Fair Credit Reporting Act)

PF.4.C.2: Discuss common crimes against consumers and examine federal consumer protection laws

Essential Question: What protections are available to me as a consumer?
Activity: What Should I Do About Identity Theft?

Content

The following pages provide instructors with the lessons, vocabulary, questions, and in-depth analysis of the unit topics. Instructors can use these passages and graphics to guide their students through the unit.

Understanding Credit & Why It's Important to You Now

Many people use credit on a daily basis. You see them in line in front of you at almost any retail store as they insert their credit card into the card reader and pay for the items in their cart. However, credit cards are only one example of credit. We also use credit to buy houses, boats, cars and other big-ticket items.

Strictly defined, credit is money loaned to consumers so they can buy something now and pay for it later. Credit makes it possible for us to buy something costly without having to save enough money to pay for it all at one time. Can you imagine trying to save $150,000 so you could buy a house and pay for it at the time of the purchase? It would take most of us at least 20 years to accumulate enough to buy the house. Keep in mind that we still have to pay rent to live somewhere while we are trying to save this money. Instead, we can borrow the $150,000 to buy the house now and then repay that money over time while we enjoy the home.

Lenders want to extend credit, or loan money, to borrowers because they make money in that process. A lender, such as a bank or a credit card issuer, charges a percentage interest rate for that loan. You can think of interest rates as the price of money. You rent the money for a period of time and you pay interest on that money until you repay the original amount.

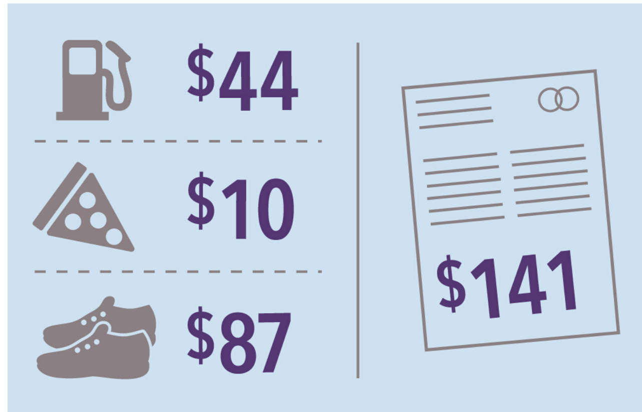
In the previous example of the $150,000 house, most people will repay that loan over 30 years by making monthly house payments. A portion of the payment goes toward the loan's accrued interest, which is the accumulated interest up to that point in time. The rest of the payment goes toward reducing the loan amount, or principal. Every month that you make a payment, your loan amount will fall, until the amount you owe reaches zero when you make the last payment.

To be able to borrow money for larger purchases later, you need to establish a good credit history now. Lenders will be very reluctant to loan you money to buy a house if you don't already have a history of borrowing money and repaying that money on time. So, how do you start establishing a good credit history? Let's begin by looking at the types of credit available.

TYPES OF CREDIT

The most common types of credit we encounter are credit cards, auto loans, home loans and student loans. Let's take a brief look at each type.

Credit Cards



Most of us begin establishing credit by getting a credit card. When you apply for your first credit card and you have no credit history, you will probably get only a very low credit limit if you are approved. For example, let's assume you get a credit card with a $500 limit. If you use that card during the month to pay for a tank of gas ($44), a pizza ($10), and a new pair of shoes ($87), you will owe a total of $141 when the bill arrives. If you pay the bill in full before the due date, you will not owe any interest.

If you are not approved for a regular credit card, you may have to apply for a secured credit card. A secured credit card is backed by a cash deposit so the issuer knows you have the money to make the payment. If you fail to make the payment, the credit card issuer will use the cash in your account to pay the amount due. Secured credit cards help people rebuild damaged credit or help people with limited or no credit establish credit. A secured credit card's limit will be equivalent to the cash you deposit to back the card.

Credit Card Features

Credit cards can be a useful tool to begin establishing credit, and they also provide a convenient way to make purchases. However, credit cards have a number of different features we need to discuss. It's important to understand these features before you use a credit card so you don't get into financial trouble.

<u>Credit limit</u>. As mentioned earlier, when the credit card is issued, it will have a credit limit. The card's credit limit is the maximum you can borrow on the card without repaying the loan. Credit limits vary widely and will change as your creditworthiness changes. Your initial credit limit may be as low as $200, but as your credit improves, you might one day be issued a card with a $25,000 or higher credit limit. While the credit card company may allow you to spend up to this amount, you need to consider how much you can repay each month.

A good financial habit to develop is to never charge more on a credit card than you can easily repay when the monthly bill comes due. Charging more than you can repay and carrying the balance over to the next month is a bad habit that results in high interest charges and can begin a cycle of poor money management decisions.

<u>**Financing or interest charges**</u>. When you carry a balance, or don't pay the card off every month, you will incur interest charges on the amount of the outstanding balance, or loan. In other words, you pay a price to borrow money from a credit card company. Credit card interest rates are very high, with the average rate above 17% as early as 2020. So how much would you pay in interest over the course of a year if you carried a $1,000 balance on your card? If the card charges 17% interest, then you would pay $170 in interest charges on that $1,000 balance you carried.

It's easy to fall into this trap since credit cards are so easy to use. People that misuse credit cards typically make the minimum payment and then charge an amount equal to the minimum payment so that their balance never falls. Therefore, it's much better to pay your balance in full every month. As you use your card and pay off your balance, you begin establishing a record of borrowing and repaying the money, or a credit history. Your credit history can be positive or negative depending on your payment history and other factors

Minimum payment. If you decide to not pay the balance in full every month, there is still a minimum payment that you must make. Minimum payments commonly range between $20 and $25 for small balances but increase as the balance increases. If your carried balance is larger than the minimum payment, it will be computed as a percentage of that balance, with a typical payment being from 1% to 3% of your unpaid balance. It's smart to resist the urge to make only the minimum payment since credit card interest rates are very high.

Late payment fees. Credit card issuers charge late payment fees if you fail to make the minimum payment by the due date. By law, credit card issuers can only charge a late fee of $25 if you have not been late in the past six months. However, if you have been late on a payment in the past six months, they can charge up to $35. There is one exception: the company cannot charge a late fee that exceeds the balance you owe.

Grace period. Credit cards usually have a grace period, or a length of time where you are not charged interest on items you buy. Grace periods must be a minimum of 21 days from the time the credit card statement is issued, and most grace periods do not exceed 25 days. The grace period only applies if you are not carrying over a balance from the previous month. If you are, new purchases start accruing interest immediately.

Annual fees. Some credit cards charge an annual fee in addition to the interest rate on unpaid balances. Annual fees vary a lot and typically range between $20 and $500 depending on the card. In most cases you can find a comparable card that does not charge an annual fee.

Rewards. Many credit cards have a reward feature. Some cards offer cash back or points on purchases. Some offer airline miles or hotel points that can be exchanged for airline tickets or hotel rooms. The type of reward offered varies widely, but you can typically expect to earn about 1% to 2% back (or the equivalent in points or miles). Rewards can be a great way to earn something extra for purchases you would have made anyway, but it's more important to focus on paying your balance in full and on time each month. A 1% reward doesn't make up for a 22% interest rate.

Other Types of Credit

At some point in your life, you may borrow money for a car, a house, or college. Borrowers typically repay these loans over several years or more.

Auto Loans

Maybe you've seen the big auto companies advertise a car that they will finance for 72 months at 1.9%. With this type of loan, you will borrow the purchase price of the car, minus any down payment you make, and pay for that car with 72 equal payments over the next six years. Included in those payments will be both the car's purchase price and the interest on the money you borrowed. After 72 monthly payments, you will own the car. As of late 2019, the most common length for auto loans is 72 months, with 84-month loans a close runner-up in popularity. Auto loans are secured by the automobile, which means the lender can repossess the car if you fail to make payments.

Mortgages

This same process occurs when you borrow money to buy a home. The main difference is that home loans, called mortgages, are usually repaid over 30 years. We will discuss mortgages and buying a home in more detail later in this lesson.

Student Loans

Student loans function in a similar way, except the government subsidizes many student loans to encourage people to get an education. On subsidized loans, the government pays the interest while you are in school and your payments do not begin until you have been out of school for six to nine months, depending on the type of student loan. On unsubsidized loans, you are responsible for the interest that accrues while you're in school.

The federal government offers both subsidized and unsubsidized loans. Private lenders only offer unsubsidized ones. Only students that demonstrate financial need are eligible for subsidized student loans. For each year you attend college, the maximum amount you can borrow increases.

Which type of loan you receive has a big impact on the final amount you owe. The following table summarizes the differences between the two types of student loans. The example uses the maximum loan amount an incoming freshman can borrow and the federal student loan interest rates that apply to loans taken out before July 1, 2020. The example assumes you graduate in four years and do not begin making loan payments until after your six-month grace period ends.

Subsidized Versus Unsubsidized Federal Student Loans

	Subsidized Loan	Unsubsidized Loan
Loan amount	$3,500	$3,500
Grace period	6 months	6 months
Interest rate	4.53%	4.53%
Loan payment while in school	$0	$0
Total amount owed after 4.5 years	$3,500	$4,272.21
Total interest accumulated while you are in school and during the grace period	$0	$772.20

For subsidized loans the government pays the interest while you are in school. For unsubsidized loans, the interest accumulates and it increases the amount you owe. Notice that the unsubsidized loan results in $772 more you will have to repay after you leave school in 4.5 years. The following website has a lot of information on student loans: https://studentaid.ed.gov/sa/types/loans/subsidized-unsubsidized#subsidized-vs-unsubsidized

Personal Loans

While the previously mentioned loans are personal loans, this term often refers to a distinct category of unsecured debt. Personal loans are short-term unsecured loans that are typically paid back in equal monthly payments over two to five years. However, some personal loans can be backed (secured) by other assets. Assets used to back any loan are known as collateral.

Each and every time you borrow and repay money, whether it's for a credit card or a student loan, your lender reports your behavior to a credit bureau. Credit bureaus track everyone's credit history and then use that information to create a numeric credit score that future lenders can look at to determine your creditworthiness. When new lenders see your credit score, they can quickly determine whether they want to loan you money. In the next section, we will discuss credit reports and credit scores.

Instructor Note: To assess mastery for this section, have your students complete the "When Do I Borrow Money?" exercise on page 24.

Credit Reports and Scores

There are three main credit bureaus that track your credit history and earn their money by selling your information to lenders. For example, when you apply for a car loan, the car dealership will require a credit report prior to making the loan. In most cases the car dealership will ask your permission to run a credit report and charge you $20 to $40 for the report since they have to pay the credit bureaus for the report. After the car dealership reviews the report, they will determine whether you are a good credit risk. So, what's included in a credit report?

As we discussed earlier, credit reports contain information on all your previous debts and repayment history. The credit report will answer the following questions:

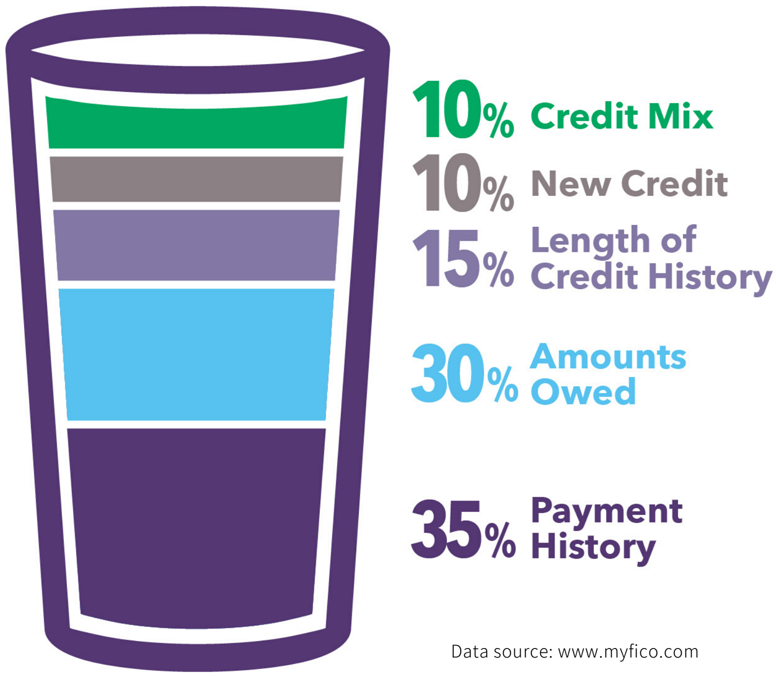
- Were you late on any payments?
- Did you stop making payments altogether (default on the loan)?
- How much money do you owe right now?
- Have you ever filed bankruptcy?
- How many loans have you applied for recently?
- How long have you had a credit history?
- How much available credit do you have and how much are you using?
- What types of credit do you have?

The credit bureau uses this information to compute your credit score. The most common credit score is called a FICO score since it was created by Fair, Isaac, and Company. Bill Fair and Earl Isaac founded the company in 1956 to develop analytical tools to help improve business decisions. Fair was an engineer and Isaac was a mathematician. The two men combined their skills to develop and sell their first credit scoring system in 1958.

The FICO score system in use today was introduced in 1989, but it has been revised several times since then. More than 90% of lenders use your FICO score to help them determine whether to give you a loan. VantageScore is the other main credit scoring system, and it is used by a few lenders. It was created in 2006 as a joint venture among the three main credit bureaus and designed to be a competitor to FICO. VantageScore uses similar factors to determine a credit score but has yet to gain widespread acceptance.

Your FICO score ranges from 350 to 850, with higher numbers indicating better credit. About 35% of your FICO score is based on your payment history (paying on time is best), and another 30% is based on the percentage of your available credit you are using (less is better). Another 15% of your score is based on the length of your credit history (longer is better), and the remaining 20% is based on the types of credit you have (lenders prefer to see a mix of types, such as auto loans, home loans, and credit cards) and how many new accounts you have opened recently (fewer is better).

FICO Score



Data source: www.myfico.com

Some recent changes allow individuals to link their bank accounts and money market accounts to FICO so additional information can be used to compute their credit scores. The current version of FICO does not have income data available to factor into your credit score. However, FICO recently introduced the UltraFICO score, which evaluates creditworthiness by looking at saving and spending patterns (which would include income information) in addition to the credit factors used to compute the traditional FICO score. This new product was not available until 2019, so it remains to be seen how many people take advantage of this option.

To learn more about your FICO score, go to this website:
https://www.myfico.com/credit-education/whats-in-your-credit-score

FICO credit scores above 740 are considered very good. You will not have any trouble borrowing money at the lowest available interest rates if your FICO score falls between 740 and 850. In the next section, we will look at some ways your credit score may be used and how it can help you or hurt you.

FICO Scores by Percent of Scorable Population

FICO Score Ranges	Rating	Description
<580	Poor	Your score is well below the average score of U.S. consumers and demonstrates to lenders that you are a risky borrower.
580-669	Fair	Your score is below the average score of U.S. consumers, though many lenders will approve loans with this score.
670-739	Good	Your score is near or slightly above the average of U.S. consumers and most lenders consider this a good score.
740-799	Very Good	Your score is above the average of U.S. consumers and demonstrates to lenders that you are a very dependable borrower.
800+	Exceptional	Your score is well above the average score of U.S. consumers and clearly demonstrates to lenders that you are an exceptional borrower.

Source: www.myfico.com/credit-education/whats-in-your-credit-score

Your Credit Score Can Help or Harm You

Every individual has their own FICO score. This score is used to decide whether to extend you a loan and the terms of the loan. It's also used to determine insurance rates and to screen applicants for apartments and certain jobs. Individuals with higher scores can easily borrow money and will pay lower interest rates on the loans. Someone with a low score might be denied a loan altogether or pay a much higher interest rate if they do get approved.

Keep in mind that lenders must decide whether you are likely to repay the loan. If the risk of default (nonpayment) is higher, they need to make more money on the loan to compensate them for taking extra risk. For example, a lender might offer to make a car loan for 15% interest to someone with a FICO score of 580 but would be willing to make the same loan for 3% interest to someone with a FICO score of 775.

Over your lifetime, a good credit score can save you thousands of dollars in lower interest rates and lower auto insurance premiums. A good score will ensure you don't get turned down for a job or turned down on a rental application. Think about this question: What bank wants to hire an employee to handle money when they do a poor job of handling their own money?

Insurance companies have noticed that people with lower credit scores file more insurance claims. For this reason, they charge highern premiums to people with lower credit scores (bad credit). Landlords also run a credit report before leasing you an apartment or home. If your credit score is too low, they might deny your lease application. It may be hard to find a place to live with a low credit score.

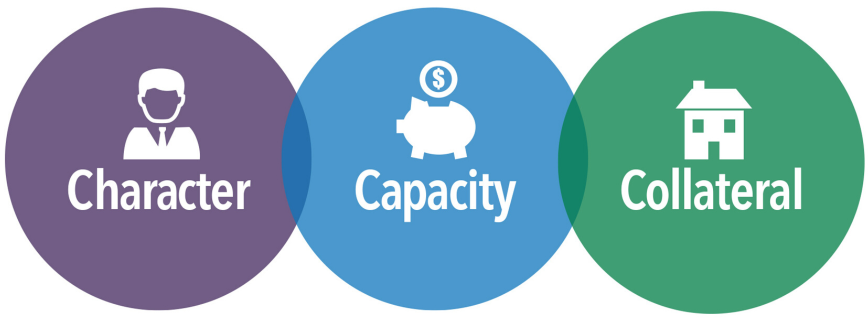
You can see that your credit history and your credit score are very important. They follow you for your entire lifetime and it's difficult to repair damaged credit. The best policy is to establish good financial habits early on and view maintaining a good credit score as a critical piece of your financial plan. At some point you may find that dream job or your forever home, and you don't want poor credit to keep you from achieving either goal.

Instructor Note: To assess mastery for this section, have your students complete the "Would You Loan Me Money?" exercise on page 32.

Understanding Loans

How Lenders Evaluate Borrowers

We know that your credit score is a critical component that lenders evaluate when deciding whether to give you a loan. While important, your FICO score is not the only thing they consider. Lenders commonly use something called the 3 Cs of credit to evaluate a potential borrower. These three Cs are character, capacity and collateral. Let's look at each C to understand how the model works.



Character considers whether you have the honesty, integrity and desire to repay the money you borrow. Lenders use your credit history to assess your character. They will look at whether you pay your bills on time, whether you move around a lot, how long have you been employed and other factors. In general, lenders like to see stability. They prefer to loan money to someone who has lived at the same address for a longer period and worked at the same place for a longer time.

Capacity refers to your ability to repay the debt. To assess your capacity, the lender looks at your current salary and any other income you may receive. This information is not included in your credit report, so you will provide this information on the loan application.

While not all lenders verify your income, you are committing fraud if you provide false information on the loan application. Mortgage lenders always verify income by requesting copies of your tax returns and income verification from your current employer. The lender will also look at your current payments including auto, home, minimum payments on credit card balances, and any other fixed payments you may have. These two factors help them decide whether you can afford the new payment if they make the loan.

Collateral refers to any asset, or thing you own, that can be pledged against the loan. If you pledge it against the loan, or use it as collateral, then the lender will become the legal owner of that asset if you stop repaying your loan. For example, most car loans use the car as collateral and allow the lender to repossess the car if the borrower doesn't make the payments. Likewise, the home is used as collateral for a mortgage. Investment portfolios and other valuable assets can also be used as collateral. Your toy collection, not so much.

Instructor Note: Ask your students the following question: "Why might your mortgage payment go up or down based on the length of your loan?"

Buying a Home

At some point, you may decide to buy a home. Home ownership has long been considered part of the American dream. However, it can be costly and many people opt not to become homeowners. In the past, many people bought homes because they thought home values would always increase and buying a home was another way to accumulate wealth. However, after housing values in many regions of the country fell during the Great Recession from 2007 to 2009, many people realized that housing values are not guaranteed to increase. Many people found themselves “upside down” or “underwater” on their mortgages. These phrases are both used to indicate that someone owes more money on their home than it is worth because it declined in value after purchase. Home ownership also makes it more difficult to move for a new job in a different part of the country. For these reasons, and personal preference, many people choose to rent.

However, if you do decide to buy a home, you will make a monthly mortgage payment that typically has four components: principal (the amount you borrowed to buy the home), interest (the rate you’re paying to borrow the principal), real estate taxes (also called property taxes) and homeowners insurance. This breakdown is sometimes referred to as PITI (principal, interest, taxes and insurance).

As you would expect, your monthly mortgage payment will depend on several factors. These include the amount you finance, the interest rate and the length of the loan. The more you finance, the higher your monthly payment will be. Also, based on what you’ve learned about credit, you understand why people with higher credit scores get approved for lower interest rates on their mortgages.

How does loan length affect your mortgage payment? While most mortgages are financed for 30 years, or 360 months, you can also get shorter-term mortgages. Some homebuyers choose 15-year mortgages so they can pay off their homes quicker. Fifteen-year mortgages usually have a slightly lower interest rate relative to a 30-year mortgage. They can also be much less expensive in the long run since you’ll be paying interest for fewer years. However, keep in mind that a shorter-term mortgage will have a higher payment since you will need to pay more toward the loan principal each month.

Mortgage rates change every day based on market rates of interest. The following table shows some sample mortgage rates for different mortgage types posted on Yahoo! Finance on November 14, 2019. Mortgage rates also vary based on the lender, any points you pay, and your credit.

Mortgage Rates as of November 2019

30-year fixed rate mortgage	4.00%
30-year fixed rate mortgage with 1.871 points	3.38%
15-year fixed rate mortgage	3.38%
15-year fixed rate mortgage with 0.924 points	3.00%

In some neighborhoods, you may also have monthly homeowners' association (HOA) fees, and in condos you will certainly pay them. HOA fees cover the cost of amenities that everyone in a neighborhood or building shares. Fees can be several hundred dollars a month depending on what they cover. You should know if you will be responsible for HOA fees and how much they will cost before you buy a home.

Common amenities covered by these fees include a community pool, common area maintenance such as community landscaping, a community center and other amenities. In condo buildings they will cover things like the roof, building exterior, elevators and lobby. Remember, not every neighborhood has HOA fees so make sure you check before buying a home.

When you borrow money to buy a home, you'll also pay several one-time expenses called closing costs, which typically include the following:

<u>Loan application fee and credit report fee</u>: The cost to process your loan application and obtain your credit report is typically between $100 and $500.

<u>Loan origination fee</u>: Lenders typically charge a fee to complete the paperwork associated with making the loan. It is commonly about 1% of the loan amount. That may not sound like much, but 1% of a $150,000 purchase is $1,500. This will usually be your largest closing cost.

<u>Home appraisal</u>: You will be required to pay for an appraisal to make sure the home is worth the loan amount. The lender will require the appraisal since the home is used as collateral on the mortgage. Collateral is important to the mortgage lender because if you don't make your mortgage payments, the lender will be able to evict you and sell the house to recover the loan amount. This process is called foreclosure, and it's very damaging to your credit.

<u>Title insurance</u>: Every piece of real estate has a title, which is a legal document that gives someone ownership of the property. A title company will research the home's title to make sure there are no legal claims, or liens, against the home. For example, did the previous homeowner have carpet installed that they failed to pay for? If so, the carpet store probably went to the courthouse and placed a lien on the house. This lien must be paid before the house can be legally sold with a clear title.

The title insurance company will research the home's history and issue insurance stating that are no liens against the property. If the title search uncovers a lien, it must be resolved before you can get a clear title. In most cases, the property owner will resolve the lien so they can complete the sale. Obtaining title insurance ensures that you are the property's legal owner and that no one else has any legal claim to the property.

<u>Pest inspection</u>: You may be required to get a pest control firm to do a termite inspection to make sure there is no existing damage.

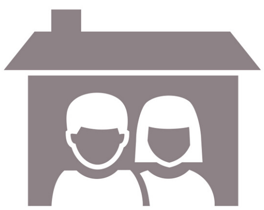
<u>Points</u>: You may choose to pay points to get a lower interest rate. Some lenders will quote several different interest rates for mortgage loans. The lower interest rates require the borrower to pay a fee to get the lower rate. These fees are known as points and they are expressed as a percentage of the loan amount. For example, a lender might quote a 5% mortgage rate with no points and a 4.5% mortgage rate with 2 points. Each point is equivalent to 1% of the amount borrowed.

The borrower that wants the lower 4.5% mortgage will have to pay a fee of 2% of the loan amount at the time the money is borrowed to get this lower interest rate. If the lender has loan options with points, they will let you know before you begin the loan process so you can decide whether you want to pay the points and buy the interest rate.

down. Points are optional to the borrower, so you may not have this closing expense. In most cases, paying the points is not a good financial decision unless you intend to live in the home and keep the same mortgage for a very long time.

Real estate sales commission: Real estate agents make money when people buy and sell homes. Their fee is traditionally 6% of the selling price, though many agents charge less. However, in most cases, the seller pays this fee.

As you can see, closing costs will easily run several thousand dollars. Potential homebuyers usually save up a lump sum of cash to cover these expenses. In some cases, you may finance these costs by rolling them into the mortgage. Let's look at a couple of examples of how closing costs can affect the amount you pay for the home and the amount you borrow. Assume the listing price is what each person paid for their respective homes.



Example A:
Alan and Terra Smith found a house they would like to buy that is listed with a real estate agent for $85,000. They are working with a lender that will make the loan for a 1.25% origination fee. While the home appears to be in good shape, Terra wants a home inspector to look over the house to see if there are any glaring problems with the heat and air system, plumbing, roof and other areas, especially because it is an older home.

The home inspector charged $340 for the inspection. Alan and Terra will also incur other closing costs including title insurance ($250), a loan application and credit report fee ($100), an appraisal ($500) and a termite inspection required by the lender ($120). The total closing costs for their loan are $2,372.50. If Alan and Terra finance these costs, they will borrow a total of $87,372.50, as the following table shows.

Example B:
Ashley Brogan has located a new home that she would like to buy in a growing subdivision. The house is listed for $165,000 and has great access to her new job. Ashley's lender will make the loan for an origination fee of 1%. Since the home is new and includes a one-year builder's warranty, Ashley decides to skip the home inspection.

She will still need title insurance ($330) and a home appraisal ($500). She also pays a $75 loan application fee and decides to pay 1 point to buy her interest rate down. Ashley's total closing costs for the loan are $4,205, as the following table shows, and her total costs including the purchase price are $169,205

Costs to Buy a Home

Type of Cost	Alan & Terra's Costs	Ashley's Costs
Loan Amount	$85,000	$165,000
Points (each pt. = 1% of loan amount)	$0	$1,650
Loan Application Fee	$100	$75
Home Appraisal	$500	$500
Home Inspection	$340	$0
Title Insurance	$250	$330
Termite Inspection	$120	$0
Origination Fee	$1,062.50 (1.25% of $85,000)	$1,650 (1% of $165,000)
TOTAL COSTS	**$87,372.50**	**$169,205**

Notice that not everyone incurs the same costs. Some costs will be incurred by everyone, such as the home appraisal fee and the loan origination fee. Other costs are optional, or may only be required by a specific lender.

Costs can also vary by lender, though federal laws do limit the amount of some fees for certain mortgage categories. After you buy the home, you will also be the one responsible for maintaining the home. For example, if your water heater breaks, you will need to replace it. If a storm damages your property, you will need to cover the portion of the cost not covered by your homeowner’s insurance.

Homeowner’s insurance is a financial product that homeowners buy to protect them from financial loss in case of fire damage, storm damage, or some other event covered by the insurance. For example, if your home was struck by lightning and it burned to the ground, your homeowner’s insurance would pay you for the value of the home and also pay you for the personal belongings that you lost in the fire. You would only pay the insurance deductible.

An Alternative to Homeownership: Renting

Because of these costs and responsibilities, many people rent instead of buy. Specifically, statistics show that about one-third of households rent instead of buy. Many renters are in their 20s. Young people may move more frequently early in their careers, and many do not have children.

These two factors make renting attractive. In addition, they may not have saved enough for a down payment yet. As people move into their 30s, they often transition to home ownership. In a few places, real estate is so expensive to buy that adults may rent for their entire lives.

If you rent, the landlord is responsible for all the property maintenance. The owner also pays the insurance and taxes. However, in some areas, rent is more expensive than home ownership. Also, renters do not build equity, meaning they don’t accumulate ownership in the place where they live. When you take out a mortgage to buy a home, you will eventually own your home outright.

In contrast, a person that rents for 30 years will continue to pay rent until they die. However, they will never have to pay for a new roof, either. Renters are also more mobile and don’t have to worry about selling a home if their job requires a geographic relocation. People that know they will move every few years are often better off renting.

Instructor Note: To assess mastery for this section, have your students complete the “Should You Rent or Buy?” exercise on page 30.

Your Credit:
Protection & Problem Solving

Common Fraudulent Practices That Could Affect Your Credit

Sadly, there are a lot of criminals that want to make easy money at your expense. One of the ways they can do this is by stealing your identity. Identity theft can take several forms.

The con artist could use your personal information to apply for credit and then run up the bills and never make the payments. Or they could steal your existing credit card information and use it to buy things they want. Identity theft occurs any time someone uses your personal information without your permission for their own gain (at your expense).

While identity theft is illegal, it is difficult to detect in time to protect your credit. In many cases the thief lives outside of the United States and cannot even be located. In other cases, the thief may be a family member or someone you thought was a friend that uses your identity for financial gain. Let's look at a few of the more common identity theft tactics.

<u>Shoulder surfing and dumpster diving</u>
These techniques involve peering over your shoulder or overhearing a conversation that contains personal data. Some thieves even look for personal information in the trash dumpsters. Sometimes the information is stolen by an employee when you pay with your credit card.

<u>Pretexting</u>
This type of con often involves calling someone on the phone and posing as someone else. Common techniques include someone pretending to be from the IRS and claiming you need to make a payment now or your paychecks will be garnished or seized. Elderly people are often the intended target for thieves using pretexting.

<u>Phishing</u>
Phishing involves sending you an email asking you to verify or provide checking account or credit card account information or your login credentials. You may receive an email telling you that your account has been suspended due to suspicious activity and you need to verify personal information to get your account reactivated.

Other common email scams may tell you that you have won a large sum of money or may ask you to help them get a large amount of money transferred to the United States. This type of con is very prevalent and typically done by someone in another country. While it is technically not identity theft, it involves someone trying to get your personal bank account information so they can transfer funds out of your account, and not into your account as their plea suggests.

<u>Skimmers</u>
Card skimmers are devices that can be attached to ATMs or data-stealing software installed in card readers at a store. In both cases the thieves can steal your account number and PIN to gain ready access to your account.

<u>Mobile phone takeovers</u>
Mobile phone takeovers, also called device takeovers or phone porting, occur when someone takes control of your mobile device to commit fraud. The most common method occurs when some contacts your carrier and impersonates you to obtain your account information. Any time you use your device for account verification, a crook has the ability to hijack your phone and access your bank accounts.

Protecting Against Identity Theft

Given that identity thieves are getting more sophisticated every year, what can you do to protect yourself? There is no magic wand that will prevent all identity theft, but there are things you can do to limit your risk and minimize your potential losses. The following list is not exhaustive but contains several recommendations from experts.

Things Everyone Should Do:

- Buy identity theft insurance that protects you against loss. There are several reputable providers of this type of insurance.
- Consider using a contactless payment system, such as a mobile wallet in a cell phone.
- Keep a list of all your account numbers and PINs in a safe place.
- Monitor all of your accounts frequently for suspicious activity. You can set up mobile alerts to notify you when money comes out of one of your accounts, or when a credit card is used, so you can quickly identify fraudulent activity.
- Frequently check your credit report for suspicious account activity.
- Use antivirus software on your computer.
- Use a password manager.
- Use two-factor authentication.
- Freeze your credit and only unfreeze it temporarily when you need to apply for credit.
- Don't give out your Social Security number unless absolutely necessary.

Things You Should Never Do:

- Never respond to emails claiming you have won a large sum of money.
- Never save credit or debit card information to an online account.
- Never give someone your personal information over the phone unless you initiated the call to a known source.
- Never use ATMs in out-of-the-way places.
- Never use an ATM if the card insert appears to be loose or tampered with.
- Never click on links in emails unless you know the source.
- Never respond to emails asking you to verify account information.
    - — Look for signs that an email is fraudulent. These include:
        - · misspelled words
        - · odd-looking logos
        - · poor grammar
        - · threats of legal action
        - · requests for immediate response

These are just a few of the things you can do to help prevent identity theft. So, what happens if you become a victim of identity theft or you think an account has been compromised? You need to act quickly before too much damage has been done. To begin with, you should:

- Call the compromised account provider and suspend the account
- Contact the three major credit bureaus and notify them about the compromised account or fraudulent activity. These are Experian, Equifax, and Transunion.
- File a police report with your local police department.
- Contact government agencies if appropriate. These may include the Consumer Financial Protection Bureau, the Federal Trade Commission, the Internal Revenue Service, your state attorney general's office, or another government agency.

- Get an updated copy of your credit report from each of the three major bureaus to determine the extent of the identity theft. Look for accounts you didn't open and loans you didn't apply for.

Follow all the instructions you receive from your bank, credit card provider, the police, and credit bureaus. These steps can help limit your loss.

Fixing Credit Issues

You may find yourself in a situation where you've made some credit mistakes or you find an error on your credit report. How do your resolve these issues? If you find an error on your credit report—and they are very common—you need to contact the credit bureau that has the incorrect information. Contact them in writing, typically via email, and keep a record of that contact. The credit bureau will contact the reporting entity that submitted the wrong information and then decide whether the information is correct or incorrect. If the decision is not in your favor, you are allowed to post an explanation to your credit report. Unfortunately, you may find that even simple errors are difficult to correct and may stay on your report for a long time.

Sometimes people misjudge their ability to repay a loan. Other times things such as divorce or illness happen that make it difficult or impossible to make payments on time. When this occurs, it will harm the person's credit since these missed and late payments are reported to the credit bureaus. If you find yourself in this situation, there are some options that can help you begin to repair your credit.

<u>Debt consolidation</u>
Debt consolidation occurs when you take several smaller loans and combine those amounts into one larger loan on an existing or new credit line. When you consolidate your debt, you can often lower your interest rate and reduce the amount you pay monthly to satisfy your creditors. This strategy can be very beneficial as long as you do not immediately begin to overuse your credit again and build up new balances on the credit cards you just paid off with the consolidation.

<u>Credit repair and credit counseling</u>
Credit repair services refer to any strategy used to fix credit issues. Credit repair firms help you challenge errors on your credit report and may help you negotiate better terms with your creditors. They may even help you consolidate your debt. However, you can do all of this yourself and you need to be cautious about credit repair firms that charge high fees. Many of these firms engage in predatory practices and simply make your situation worse. You can sometimes find free services in your local community or region to help you repair your credit and counsel you on budgeting and reducing your spending.

<u>Bankruptcy</u>
Bankruptcy is a legal process where you ask the courts to help you pay off your debts and protect you from creditor harassment. For individuals, there are two bankruptcy options: Chapter 7 and Chapter 13.
- <u>Chapter 7 bankruptcy</u> involves selling all of your assets, except for a few exemptions, and using the proceeds to pay a portion of the debt you owe. You then start over without assets or debt.
- <u>Chapter 13 bankruptcy</u> can reduce some of the amount you owe and it typically involves a three- to five-year process where you make scheduled payments to repay a court-determined amount. This type of plan is often called a wage earner's plan and it allows you to keep all of your assets.

Keep in mind that bankruptcies are reported to the credit bureaus and stay on your record for up to seven years for Chapter 13 and 10 years for Chapter 7. A bankruptcy will not eliminate or reduce any taxes you may owe, back alimony or child support you may owe, any debt obtained through fraud, and in most cases student loan debt. Bankruptcy should be considered the last resort to help you recover from excessive debt.

Predatory Lending Practices

There are numerous ways to borrow money that most experts consider to be predatory practices. A predatory practice or predatory loan is any source of high interest or high cost funds that preys on the poor and uneducated. Avoid these arrangements if at all possible. The following list includes some common predatory practices.

<u>Payday loans</u>

Payday loans require the borrower to give the lender a post-dated check or the ability to auto-debit their checking account to repay a short-term loan. As an example, someone needing money might write a $300 check to a payday lender that has a date two weeks in advance. The payday lender will give the person some amount less than the check amount and then deposit the check two weeks later. So, the lender might give you $250 for a $300 post-dated check; the $50 difference is the lender's fee. This practice is equivalent to charging several hundred percent a year in interest. Additionally, people who utilize payday lenders tend to do it over and over again and never cease using this type of debt: payday borrowing can be a difficult cycle to break out of.

The practice of payday lending was outlawed in Arkansas in 2008, but borrowers can still find online payday lenders. For more information about payday loans in Arkansas, please check out the following website: https://arkansasag.gov/consumer-protection/money/one/illegal-payday-lending

<u>Pawn shops</u>

Pawn shops are another source of high-interest loans that often prey on the poor and uneducated. A borrower takes some item of value to the pawnbroker and uses the item as collateral for a short-term loan. If the borrower fails to pay within the allotted time, the pawnbroker will sell the item to recover the loan amount. For example, a person needing money might take their wedding ring to a pawn shop and pawn the ring for $100. If the item is not retrieved in time, the ring will be sold. In many cases the item's value far exceeds the money the borrower received when they pawned the item.

<u>Tax refund loans</u>

Some income tax preparers will offer to loan consumers some amount slightly less than their anticipated tax refund. For example, someone might get an immediate loan of $950 after the tax preparer files their taxes and the person is expected to get a $1,000 refund. The loan, and a fee for making the loan, is repaid when the refund arrives. However, in most cases, tax refunds will arrive in two or three weeks, so this practice is equivalent to a high-interest, short-term loan.

Illegal Payday Lending

Since 2008, the Attorney General's office has worked to eliminate all forms of payday lending in Arkansas. Payday lending is the practice of extending short-term loans at high annual percentage rates. It also includes so-called "installment" loans with longer terms, which carry high interest rates. Though all storefront payday loan operations in Arkansas have been shut down, these usurious loans are still available on the internet. Most online payday lenders have "roll-over" provisions that direct most, if not all, of a debtor's payments toward loan fees without reducing the amount borrowed.

How to spot a payday loan:

- High Interest Rate: Payday loans typically carry triple-digit interest rates or high fees, even if the fees are not called "interest."
- Short Terms: Typically, a payday loan is payable within two weeks to one month.
- Direct Bank Account Access: Payday lenders usually require information about the borrower's bank account, either through a check written to the lender or through electronic access.

What should I do?

- Consider alternatives to payday loans. Contact creditors to request extensions on due dates. Seek the financial assistance of family or friends. Remember, a borrower typically pays more than $800 to retire a $300 payday loan. Ultimately, you will spend most of your money on interest payments.
- If you would like to file a consumer complaint against a payday lender or a payday loan debt collector, submit an online complaint to the Consumer Protection Division or call (800) 482-8982.
- If your loan is illegal and unenforceable under Arkansas law, our office can request that the lender or collector cancel the loan.
- You may decide to prevent further withdrawals by closing your bank account to prevent the lender from accessing your funds. Stopping payment or closing your account will have consequences. You may be contacted by the lender or a debt collector. You could be sued. If sued, by law, our office cannot represent you.
- Some payday lenders, or related collection agencies, use harassing and abusive collection tactics. If this happens to you, you can file a complaint with our office. Also you should be aware of your rights under the Fair Debt Collection Practices Act.

Note: This legal information is specific to the state of Arkansas and is reproduced from https://arkansasag.gov/consumer-protection/money/one/illegal-payday-lending/.

Assessment Materials

The following assessments can be used in multiple ways. Instructors can use these materials to facilitate classroom discussions, group projects, or individual student assignments. Every activity can be completed without Internet access or other outside resources.

Exercise #1 | STUDENT VERSION

When Do I Borrow Money?

(30–45 minutes)

Name ____ Date:______________________ Class Period: ___________

Individuals may need to borrow money for cars, houses, or education. However, many people use credit for too many purchases and find it difficult to make their payments. Sometimes they may find themselves in a situation where it is difficult to get a loan when they need it. Look at each of the following scenarios and decide whether these individuals should have used credit for their purchases. Identify other options these borrowers could have used in each scenario.

SCENARIO 1: Mason enters college next fall and he has applied for financial aid. After learning his financial aid will not completely cover his expenses, he is considering taking out a student loan. He intends to go to an expensive local private college and live on campus to gain some independence from his parents. Mason is inquisitive and likes to debate big issues, so he is interested in majoring in philosophy. He will need to borrow at least $15,000 per year to cover all of his expenses.

1. What factors should Mason consider before taking on this debt?

2. What could Mason do that might keep him from incurring $15,000 per year in student loan debt?

3. What advice would you give Mason?

SCENARIO 2: Echo applied for and received her first credit card in her first semester in college. Since she had a good job and a verifiable income, she was able to get the card without having to ask her mom or dad for a signature. Her new credit card had a $2,000 limit and an annual interest rate of 18%. Now that she had the card in her hand, she wonders whether she has made a mistake.

1. What advice would you give Echo about using her credit card?

2. What are the benefits of Echo getting a credit card now?

3. What are the dangers of Echo getting the credit card?

SCENARIO 3: (Requires a financial calculator or access to the Internet) LaTasha found a used car she wants to buy from a local car dealer. However, she's not sure if she can afford the payment. After looking over her budget, she feels comfortable that she can make the payment if it is less than $300 a month. Her credit score is 765 and she's been working at the same place for three years. LaTasha found a car that the dealer will sell for $8,500 and finance for three years at 3.6%.

1. How much will LaTasha's car payment be every month?

2. Does the payment fall within her budget?

3. Should LaTasha buy the car? What factors should she consider before making the purchase?

Exercise #1 | TEACHER VERSION

When Do I Borrow Money?

(30–45 minutes)

PFM.9.E.1: Evaluate costs and benefits (e.g., interest rates, fees, penalties, rewards) of using various types of credit: student loans, credit cards, and personal loans (e.g., auto, home mortgage)

PF.4.C.5: Understand the different components of credit by:
Comparing and contrasting sources of credit (e.g., car loans, student loans, credit cards,) Discussing the establishment and use of credit, Identifying the factors that contribute to a credit score, Calculating the actual costs associated with credit, Discussing methods of solving credit problems, Evaluating the risks associated with overextending credit

PF.4.C.7: Understand the different components of loans by:
Differentiating between the different types of loans (e.g., payday, auto, home, personal, student,) Examining the lending process from application to approval, Calculating true costs associated with loans (e.g., term length, interest rate,) Understanding the factors that contribute to different interest rates, Evaluating the implications of obtaining and/or defaulting on a loan

INTRODUCTION
Individuals may need to borrow money for cars, houses, or education. However, many people use credit for too many purchases and find it difficult to make their payments. Sometimes they may find themselves in a situation where it is difficult to get a loan when they need it. Look at each of the following scenarios and decide whether these individuals should have used credit for their purchases. Identify other options these borrowers could use in each scenario.

READING (Each scenario should take about 10–15 minutes to complete.)
Read each of the following scenarios and then answer the questions associated with each one. Consider other alternatives for the borrowers in each scenario. You can have the students work individually or in groups.

SCENARIO 1: Mason enters college next fall and he has applied for financial aid. After learning his financial aid will not completely cover his expenses, he is considering taking out a student loan. He intends to go to an expensive local private college and live on campus to gain some independence from his parents. Mason is inquisitive and likes to debate big issues, so he is interested in majoring in philosophy. He will need to borrow at least $15,000 per year to cover all of his expenses.

1. What factors should Mason consider before taking on this debt?

- The total cost of his tuition per semester/per year
- The total cost of room and board
- How many years will it take to finish his degree
- The cost of any sports or other extracurricular activities
- Whether he can work while attending school
- How much he can earn from work per semester/per year during school
- How many years it will take to repay the debt
- How much his monthly debt payment will be
- What kinds of jobs he might get after college with a philosophy degree
- Whether he will be able to afford his monthly student loan payment after graduation

2. What could Mason do that might keep him from incurring $15,000 per year in student loan debt?

- He could live at home
- He could look for lower cost schools as alternatives
- He could apply for scholarships
- He could look for roommates
- He could apply for work-study jobs

- He could earn AP credits toward college
- He could take summer school classes during college to shorten his years to graduation
- He could attend college part time while working part time
- He could attend a less expensive school to complete his basic college coursework, then transfer to earn his degree from the more expensive school

3. What advice would you give Mason?
- Think long term, not just one semester at a time
- Look into several options for colleges
- Look into off-campus apartments and consider roommates
- Look up the job outlook and expected starting salary for his chosen major

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SCENARIO 2: Echo applied for and received her first credit card in her first semester in college. Since she has a good job and a verifiable income, she was able to get the card without having to ask her mom or dad for a signature. Her new credit card has a $2,000 limit and an annual interest rate of 18%. Now that she has the card in her hand, she wonders whether she has made a mistake.

1. What advice would you give Echo about using her credit card?
- Don't use for everyday purchases
- Pay off her charges in full and on time every month
- Do not use the card for cash advances

2. What are the benefits of Echo getting a credit card now?
- It will increase the length of her credit history (long term)
- It could help her build credit if she uses it responsibly
- Building credit could help her later if she needs to rent an apartment or buy a car

3. What are the dangers of Echo getting the credit card?
- If she overspends, she may not be able to pay off the balance all at once
- Carrying a balance will come at a high price (18% interest)
- If she makes late payments, she will have to pay late fees and her credit score will drop

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SCENARIO 3: (Requires a financial calculator or access to the Internet) LaTasha found a used car she wants to buy from a local car dealer. However, she's not sure if she can afford the payment. After looking over her budget, she feels comfortable that she can make the payment if it is less than $300 a month. Her credit score is 765 and she's been working at the same place for three years. LaTasha found a car that the dealer will sell for $8,500 and finance for three years at 3.6%.

1. How much will LaTasha's car payment be every month? $249.44

2. Does the payment fall within her budget? Yes

3. Should LaTasha buy the car? What factors should she consider before making the purchase?
- How many miles does the car have?
- How old is it?
- How reliable is the make and model?
- What does the vehicle history look like?
- How much will car insurance cost per month?
- How much will maintenance and repairs cost per year?

Exercise #2 | STUDENT VERSION

What Should I Do About Identity Theft?

(25–30 minutes)

Name ____ Date:______________________ Class Period: ___________

Look at the following email message and identify red flags that might indicate it is a fraudulent email.

INVALID LOGIN ATTEMPT PREVENTED

American Express

Account: 3****

ACCOUNT UPDATE

Dear Valued Member

We noticed invalid login attempts into you account online from an unknown IP address .
We have temporarily suspeded your account.
We need you to update your account information for your online banking to be re-activated
please review your billing information as soon as possible.

www.americanexpress.com/secure/verify.
You can follow onscreen instructions.

Thank you for helping us to protect the security of your account.

American Express Account Protection Services

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Exercise #2 | TEACHER VERSION

What Should I Do About Identity Theft?

(25–30 minutes)

PF.4.C.1: Identify types of fraud and credit abuse and develop strategies to protect oneself from identity fraud and theft
PF.4.C.2: Discuss common crimes against consumers and examine federal consumer protection laws

Introduction
Identity theft is a huge problem for everyone. Millions of Americans of every age suffer from identity theft every year. Despite the efforts to combat and prevent identity theft, cybercriminals' tactics continue to evolve. One statistic relevant to the following exercise is that in 2018 there were 679,000 mobile account takeovers in the United States alone. Experts estimate the losses from such takeovers exceed $4 billion per year. There are many other types of identity theft fraud with millions of people affected every year.

READING: (5 minutes)
Split the students into groups and give them copies of the following fraudulent email message. Have students identify red flags that might indicate it is a phishing email.

GROUP ACTIVITY: (10 minutes)

Have the groups brainstorm different red flags. They should be able to identify at least two red flags that indicate this email is fraudulent.

Red flags:
- The account number does not provide an ending number. When your credit card company contacts you, they will show the last digit or digits of your account number.
- The credit card company will never ask you to click on a link and verify personal information.
- The text at the bottom of the email has some errors in the firm's name.
- The logo is slightly off. Pay attention to small details.
- The message's formatting is inconsistent.
- The message's punctuation is inconsistent.

While you cannot see it here, pay attention to the email address that sent the message. Does it appear to be from a legitimate source? In addition, if you move your cursor over the link, but do not click on it, you can see where that link will take you. It is typically to an unusual URL that you should not visit.

ENTIRE CLASS ACTIVITY (15 minutes)

List all of the red flags on the board. Were you able to locate all of them? Now have the class identify the steps they should take if they actually followed through and provided their private information in response to this phishing scam.

- Call your credit card company.
- Review your account balance and charges.
- Change the password on your account.

Exercise #3 | STUDENT VERSION

Should You Rent or Buy?

(25 minutes)

Most of us will live in several different places in our lifetimes. We may stay within the same region or we may move to another state or region to go to school or take a new job. When we relocate, we have to find a place to live. One of the decisions we must make is whether to rent or buy in the new area, or whether to buy in an area where we've been renting. In this exercise, you will brainstorm some factors to consider when you make this decision.

Answer the following questions:

Why might someone decide to rent an apartment instead of buying a house?

What expenses might a homeowner incur that a renter would not?

How does the length of time you plan to live somewhere affect whether you might want to rent or buy?

List two tips you might give to a friend who is trying to decide whether to rent or buy.

Exercise #3 | TEACHER VERSION

Should You Rent or Buy?

(25 minutes)

PF.4.C.3: Compare and contrast the advantages and disadvantages of renting versus owning a home (e.g., costs, taxes, insurance)
PF.4.C.4: Analyze factors that determine/influence mortgage costs (e.g., interest rate, term length, credit rating)

Introduction
Most of us will live in several different places in our lifetimes. We may stay within the same region or we may move to another state or region to go to school or take a new job. When we relocate, we have to find a place to live. One of the decisions we must make is whether to rent or buy in the new area, or whether to buy in an area where we've been renting. In this exercise, you will brainstorm some factors to consider when you make this decision.

Spend some time discussing factors that might impact the rent or buy decision. These include:
- Cost of renting versus buying
- The amount of time you expect to live there
- Convenience
- Whether property values are appreciating (going up) or depreciating (doing down)
- Maintenance costs
- Property taxes
- Insurance costs
- Current market rates of interest
- Your credit score
- How well you know the area

Split the students into teams and have them address each of these bulleted items and why they matter when making the rent versus buy decision. Can they think of other factors that might affect the decision?

Exercise #4 | STUDENT VERSION

Would You Loan Me Money?

(30–45 minutes)

Name ____ **Date:**____________________ **Class Period:** __________

Lenders make their money by making good loans. A good loan is one that the borrower pays back on time. However, sometimes the borrower defaults on the loan and the lender loses money. Look at each of the following scenarios from the lender's perspective. Keep in mind that your job depends on your ability to make good loans.

SCENARIO 1: Jim is a junior majoring in biology at a local university and he is thinking about buying a new car. His old one still runs fine, but it has close to 200,000 miles on it and he needs the car to get back and forth to work and school. Jim works at a fast food restaurant at nights after class and on weekends. He lives alone in a two-bedroom apartment about two miles from work and school. After visiting the dealership, Jim found out his credit score was only 578. He purchased a new guitar last year on credit, was late on several payments, and skipped his most recent payment because he forgot, making his account delinquent. Jim has numerous other late payments on credit cards but has not defaulted on any loan. His memory lapses have cost him quite a few points on his credit score.

1. What factors would you consider if you were Jim's lender?

2. Would you make Jim the loan? Why or why not?

3. What would you require if you decided to loan Jim the money?

SCENARIO 2: Lakeeta graduated from college three years ago and has been working for the same accounting firm for the past three years. She passed her CPA exam in her first six months on the job and got a nice raise. She now makes $81,500 a year. Lakeeta has saved about $15,000 over the past three years and she has decided to buy a new car. Her credit score is 784 and she is curious about what kind of deal she can get on a reliable four-door sedan with good gas mileage.

1. What factors would you consider if you were Lakeeta's lender?

2. Would you make Lakeeta the loan? Why or why not?

3. What would you require if you decided to loan Lakeeta the money?

SCENARIO 3: Marcus is an apprentice plumber. In another six months, he will be able to take the state licensure exam and he will become a licensed plumber if he passes the test. He makes decent money as an apprentice but less than half of what he will make when he gets his license. Marcus is thinking about going into business for himself, but he will need a new truck if he decides to make that leap. Marcus has a few credit issues from when he first got out of high school. He bought a few things on credit and didn't fully pay them off. His credit score reflects that poor judgement and is a 495.

1. What factors would you consider if you were Marcus's lender?

2. Would you make Marcus the loan? Why or why not?

3. What would you require if you decided to loan Marcus the money?

4. What advice would you give Marcus if you decided not to make the loan?

TEACHER VERSION | Exercise #4:

Would You Loan Me Money?

PFM.9.E.2: Analyze factors that affect credit worthiness (e.g., credit history, capacity, collateral)
PFM.9.E.3: Evaluate various strategies to correct and avoid credit issues (e.g., credit counseling, identity protection, debt consolidation, bankruptcy)
PF.4.C.6: Understand the different components of bankruptcy by: Identifying and evaluating types of bankruptcy, Examining the impact of declaring bankruptcy, and how it may affect future financial opportunities

INTRODUCTION
Lenders make their money by making good loans. A good loan is one that the borrower pays back on time. However, sometimes the borrower defaults on the loan and the lender loses money. Look at each of the following scenarios from the lender's perspective. Keep in mind that your job depends on your ability to make good loans.

READING (Each scenario should take about 10–15 minutes to complete.)

SCENARIO 1: Jim is a junior majoring in biology at a local university and he is thinking about buying a new car. His old one still runs fine, but it has close to 200,000 miles on it and he needs the car to get back and forth to work and school. Jim works at a fast food restaurant at nights after class and on weekends. He lives alone in a two-bedroom apartment about two miles from work and school. After visiting the dealership, Jim found out his credit score was only 578. He purchased a new guitar last year on credit, was late on several payments, and skipped his most recent payment because he forgot, making his account delinquent. Jim has numerous other late payments on credit cards but has not defaulted on any loan. His memory lapses have cost him quite a few points on his credit score.

1. What factors would you consider if you were Jim's lender?
- His past payment history of late payments
- His current employment and income
- His ability to take on a new monthly payment given his existing financial obligations

2. Would you make Jim the loan? Why or why not?
- Yes, because he is working and able to pay back the loan, and he hasn't actually defaulted on a loan.
- No, because of his low scores and bad repayment history.

3. What would you require if you decided to loan Jim the money?
- Higher down payment
- Higher interest rate
- Both

SCENARIO 2: Lakeeta graduated from college three years ago and has been working for the same accounting firm for the past three years. She passed her CPA exam in her first six months on the job and got a nice raise. She now makes $81,500 a year. Lakeeta has saved about $15,000 over the past three years and she has decided to buy a new car. Her credit score is 784 and she is curious about what kind of deal she can get on a reliable four-door sedan with good gas mileage.

1. What factors would you consider if you were Lakeeta's lender?
- She has money saved for a down payment.
- She makes enough money to pay her loan.
- She has a long work history.
- Her FICO score indicates a good credit history.

2. Would you make Lakeeta the loan? Why or why not?
- Yes, because she is a low risk applicant.

3. What would you require if you decided to loan Lakeeta the money?
- Banks might compete with each other to offer Lakeeta a lower interest rate, better warranty options, or extra service features to win her business.

SCENARIO 3: Marcus is an apprentice plumber. In another six months, he will be able to take the state licensure exam and he will become a licensed plumber if he passes the test. He makes decent money as an apprentice but less than half of what he will make when he gets his license. Marcus is thinking about going into business for himself, but he will need a new truck if he decides to make that leap. Marcus has a few credit issues from when he first got out of high school. He bought a few things on credit and didn't fully pay them off. His credit score reflects that poor judgement and is a 495.

1. What factors would you consider if you were Marcus's lender?
- His past loan defaults
- His current income and employment

2. Would you make Marcus the loan? Why or why not?
- No, because he has a history of not repaying loans.

3. What would you require if you decided to loan Marcus the money?
- Higher down payment, higher interest rate

4. What advice would you give Marcus if you decided not to make the loan?
- Request copies of his credit reports.
- Make arrangements to pay off past debts.
- Start to build up a savings to purchase something in the future.
- Wait until he is officially licensed before buying a truck for his business.
- To save money, buy a gently used truck instead of a new truck.

WRAP-UP DISCUSSION

Spend some time in class discussing the students' loan decisions. Is everyone in agreement? If not, debate the decisions in class. (5–10 minutes)

Additional Materials

The following materials will provide instructors with additional information and activity suggestions to expand on the topics presented in this unit. Some of these materials may require internet access. These materials were created by various other organizations, and were included in this module for their connections to Arkansas standards.