

Lesson 10

Take Control of Debt: Do Your (Credit) Homework

Lesson Description

In this lesson, students will shop for a loan, choosing from five fictitious credit offers. They will use a chart to record information about the terms of the various offers and will evaluate the terms of each credit option.

National Standards in K–12 Personal Finance Education (www.jumpstart.org)

Credit and Debt

Standard 1: Identify the costs and benefits of various types of credit.

Instructional Objectives

Students will:

- Identify factors that differentiate credit offers and their impact on the total cost of credit.
- Evaluate financing offers for a major purchase.

Time Required

One 50-minute class period

Materials Required

- Copies of classroom visuals
 - *Visual 1: Credit Option #1*
 - *Visual 2: Credit Option #2*
 - *Visual 3: Credit Option #3*
 - *Visual 4: Credit Option #4*
 - *Visual 5: Credit Option #5*
 - *Visual 6: Comparing Credit Offers*
- Copies of the following student handouts for each student
 - *Handout 1: Comparing Credit Offers*
 - *Handout 2: Shopping for Credit*
- CD-ROM Building Wealth

Procedure

Building Wealth, pages 19–24, and the **Take Control of Debt** section of the CD-ROM contain information and visuals related to this lesson.

1. Post *Visuals 1–5* along the front of the classroom. These visuals contain information about five consumer credit offers. Relate the following scenario to the students.

Your favorite football team is going to play in the big game next month, and you want to have a party. You have decided to buy a new high-definition television. After doing some research on various brands,

you have found the perfect TV. The total cost is \$1,000. Now you have to pay for it. You have several options. You are unable to pay cash, but you have seen several ads that offer financing options. You could use your bank credit card, apply for a loan from your bank or apply for one of the credit options at the store.

(Note: For large classes, multiple sets of visuals could facilitate students' movement around the room.)

2. Ask five students to quickly look over the five credit offers and do their best 30-second "sales job" to the class. Each salesperson should highlight the attractive features of each offer. After the sales talks, tell the class:

Look at the five financing options posted at the front of the room. Choose the one that you think is the best way to buy the TV. When you pick the financing offer, sign on one of the lines at the bottom of the flier. If all of the signature spaces are filled, you must select a different offer. Once you have signed on the line, return to your seat.

3. Ask students why they chose each offer. Review the five options and briefly discuss the attractive features (low interest, low payment, etc.) of each one.
4. Distribute *Handout 1: Comparing Credit Offers* to each student and have students look at the five financing options that are posted. Students should complete the interest rate and monthly payment columns using information from Visuals 1–5.
5. Display *Visual 6: Comparing Credit Offers*. Have students complete the other sections of the chart. These items can be computed from the information but require the use of a financial calculator or an online debt calculator. Discuss the total finance charges and length of repayment, using Visual 6 and the following questions:

- Which option has the lowest finance charges? Is there any drawback to that option?
Option #5 is the lowest cost (zero finance charges), but it has the highest monthly payment. It also has the highest APR if not paid off in 12 months.
- What is attractive about Option #2?
It has a low monthly payment (4% of the balance means that payments would start at \$40 per month) and low finance charges. However, the low interest rate in that offer is available to only "highly qualified applicants," and that is likely to be a very small percentage of applicants. Borrowers who qualify for this financing offer have demonstrated the capacity and the character to be good borrowers.
- How much more expensive is Option #3 than Option #2?
While the monthly payment amount is the same, the interest rate (expressed as the APR) is significantly higher. The higher interest rate leads to a more-than-five-year loan payoff (assuming the borrower makes the minimum payment each month) and finance charges that are more than 11 times higher than Option #2.
- Why is the total finance charge so much lower on Option #1 than in Option #3?
The interest rate is the same as Option #1, but the fixed monthly payment of \$50 leads to a faster payoff and lower total finance charges. The required 4% minimum payment in #3 decreases the amount due

each month as the balance falls, resulting in more monthly payments and higher total finance charges.

- What are the advantages to Option #4?

Option #4 has a very low monthly payment. The total finance charges could be reduced by opting for a slightly higher payment over a shorter loan term. For example, if the loan was for two years instead of three, the monthly payment would rise to \$47.07, but the total finance charges would drop to \$129.76. Also, this option is not available at the retail store. It is available at a commercial bank. Finding this option requires planning and research on the part of the consumer.

- What are the advantages and disadvantages to Option #5?

Option #5 allows the borrower to avoid finance charges entirely. However, the monthly payment is higher than the other options. A borrower would need to make sure that this payment would fit his or her monthly budget.

6. Play CD-ROM section **Take Control of Debt**, click on “Use Debt Wisely” and play “A Tale of Two Spenders” and “Avoid Credit Card Debt.”

7. Brainstorm factors that Tim should have considered when choosing his loan. Collect student responses on the board.

Suggested answers include the interest rate, the number of payments required to pay off the loan, the amount of the monthly payment and the total amount of finance charges.

Closure

8. Review the major concepts of the lesson¹ using the following questions:

- What loan terms should a borrower look for on a credit offer?

Answers will vary but should include minimum payment, length of loan and annual percentage rate (APR).

- Where can a borrower find information about the terms of a credit offer?

The terms are found in the disclosure statement that is included in every credit offer.

- What factors affect the total finance charges on credit?

The total amount of the loan, the interest rate and the length of the loan determine the total cost of credit.

9. Tell students that to find the dollar amount of the monthly payment and the total amount of the finance charges, people who are considering a loan can use a financial calculator or an online payment calculator like the one found at <http://dallasfed.org/educate/calculators/index.cfm>.

Assessment

10. Distribute *Handout 2: Shopping for Credit*. Allow students to complete the assignment as homework.

¹The television shopping activity is based on a presentation by Tim Shaunty of the Texas Council on Economic Education.

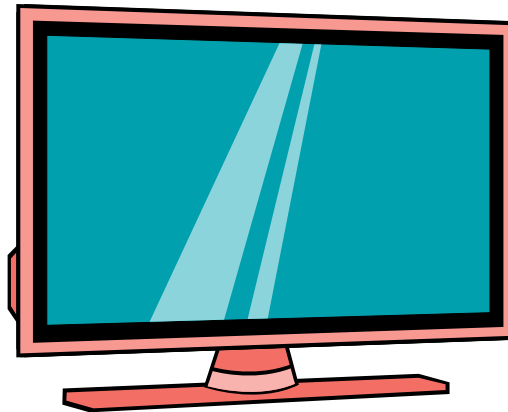
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Visual 1: Credit Option #1



Get the TV you want for the game this weekend!

Low monthly payment of \$50



Disclosure: 21% APR with a minimum finance charge of \$1; minimum monthly payment of \$50; no annual fees.

x _____

x _____

x _____

x _____

x _____

x _____

x _____

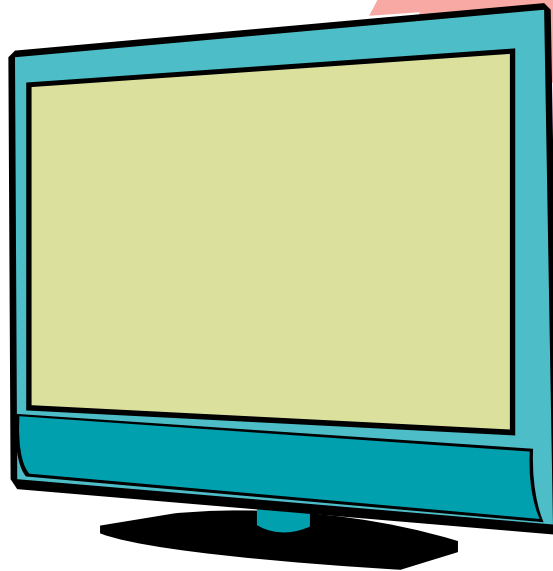
x _____

Visual 2: Credit Option #2

Do you have good credit?

**Qualified buyers pay
only 3% interest on
all purchases!**

**Shop today!
Enjoy your new TV
tonight!**



Disclosure: Available only to highly qualified applicants. 3% APR with a minimum finance charge of \$1; minimum monthly payment of 4% of the balance; no annual fee.

x _____

x _____

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Visual 3: Credit Option #3

Dear Customer,

Because you are a valued customer of XYZ Bank, we are pleased to enclose your new credit card with a spending limit of \$7,500. It is accepted at merchants worldwide and offers flexible payments with a low minimum payment. You now have the freedom to take that dream trip or buy a new TV for the upcoming game. Thank you for your business.

Sincerely,

Your friends at XYZ Bank



P.S. Minimal monthly payment of 4% of balance required.
See additional terms below.

Annual percentage rate (APR) for purchases	21%
Other APRs	Cash-advance APR and Balance-Transfer APR: 28% Penalty rate: 32% See explanation below.*
Variable-rate information	Your APR for purchase transactions may vary. The rate is determined monthly by adding 11.9% to the Prime Rate. **
Grace period for repayment of balances for purchases	25 days on average
Method of computing the balance for purchases	Average daily balance (excluding new purchases)
Annual fees	None
Minimum finance charge	\$.50
Transaction fee for cash advances: 3% of the amount advanced Balance-transfer fee: 3% of the amount transferred Late-payment fee and Over-the-credit-limit fee: \$25	
* Explanation of penalty. If your payment arrives more than ten days late two times within a six-month period, the penalty rate will apply. ** The Prime Rate used to determine your APR is the rate published in the <i>Wall Street Journal</i> on the 10th day of the prior month.	

X _____

X _____

X _____

X _____

X _____

X _____

X _____

X _____

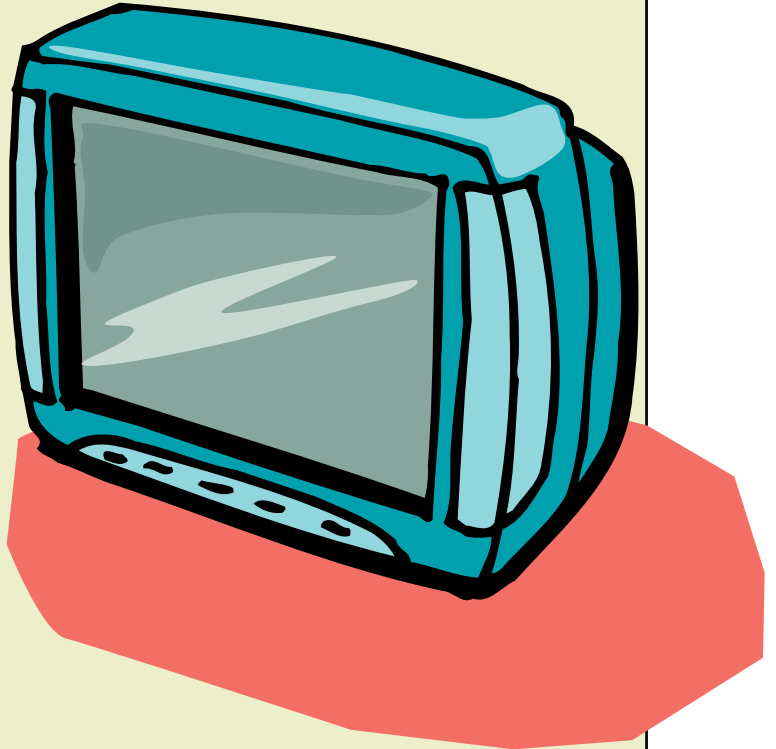
Visual 4: Credit Option #4

Get the television you want with a loan from ABC Bank!

Nothing down.

36 months to pay.

See a loan officer to apply!



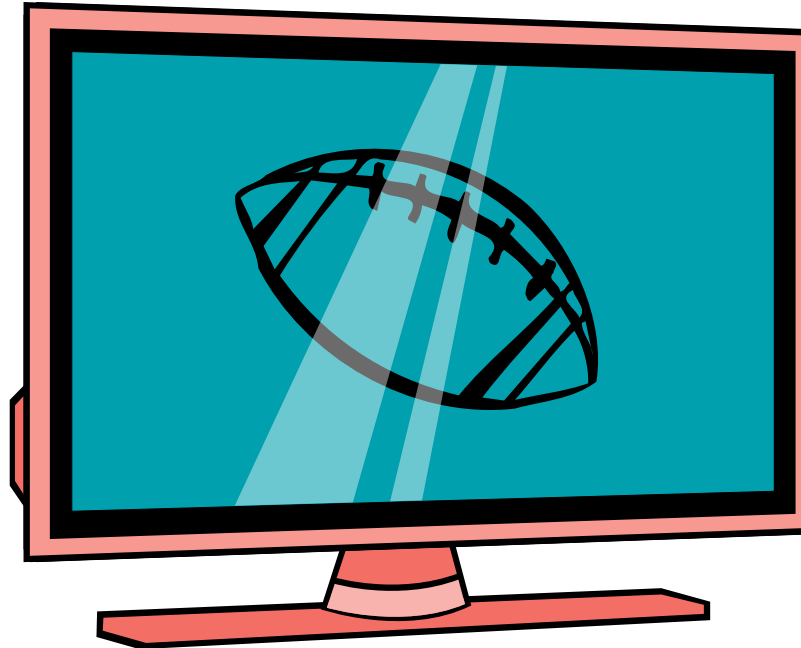
Terms: Zero down; 12% APR; 36 payments of \$33.21 for every \$1,000 borrowed.

x _____
x _____
x _____
x _____

x _____
x _____
x _____
x _____

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Visual 5: Credit Option #5



Pay No Interest! 12 Months Same as Cash*

*Same as Cash offer on approved store card purchases. Subject to credit approval based on your credit worthiness; other terms may apply. No finance charges if purchase paid in full in 12 months. If purchase is not paid in full or your account is not kept current, finance charge will be assessed from purchase date.

Variable APRs as of 01/01/09:

Standard Rate: 23.9%, Default Rate: 25.9%, Minimum Finance Charge \$2

X _____

X _____

X _____

X _____

X _____

X _____

X _____

X _____

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Visual 6: Comparing Credit Offers

	Interest Rate	Monthly Payment	Number of Payments	Total Finance Charges	Total Cost of the TV
Option #1	21% APR	\$50	25	\$241.61	\$1,241.61
Option #2	3% APR	4% of the balance (Starts at \$40 per month)	63	\$58.48	\$1,058.48
Option #3	21% APR	4% of the balance (Starts at \$40 per month)	95	\$664.98	\$1,664.98
Option #4	12% APR	\$33.21	36	\$195.72	\$1,195.72
Option #5	12 months same as cash	\$83.33 (\$1,000/12)	12	0	\$1,000.00

Note: All finance charges were computed assuming that the borrower made the minimum payment each month as specified in the credit offer. Finance charges might be lower if the loan is paid off early.

Name: _____ Date: _____

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Handout 1: Comparing Credit Offers

	Interest Rate (APR)	Monthly Payment	Number of Payments	Total Finance Charges	Total Cost of the TV
Option #1					
Option #2					
Option #3					
Option #4					
Option #5					

Name: _____ Date: _____

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Handout 2: Shopping for Credit

Find three credit offers in newspaper advertisements, on the web or in a store. Attach the original ad and use the space below to identify key provisions of the offer.

Ad #1

Merchant or Creditor: _____

Special provisions (such as reduced interest or delayed payments): _____

Terms of credit (such as minimum payment, interest rates, number of payments, penalties): _____

Ad #2

Merchant or Creditor: _____

Special provisions (such as reduced interest or delayed payments): _____

Terms of credit (such as minimum payment, interest rates, number of payments, penalties): _____

Ad #3

Merchant or Creditor: _____

Special provisions (such as reduced interest or delayed payments): _____

Terms of credit (such as minimum payment, interest rates, number of payments, penalties): _____

Questions to Consider

How does making only the minimum payment affect the time required to pay off a credit card? How does this affect the total amount of finance charges?

What is the relationship of the interest rate and the total finance charges?

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Handout 2: Shopping for Credit

Suggested Answers

Credit Research

Student research should be assessed by considering the criteria:

- Did the student collect three credit advertisements from different creditors?
- Did the student identify relevant terms of credit from the disclosure information?
- Did the student identify special provisions that are designed to attract consumers?

Questions to Consider

How does making only the minimum payment affect the time required to pay off a credit card? How does this affect the total amount of finance charges?

Making only the minimum payment lengthens the time required to pay off the revolving balance. Since finance charges are incurred each month a balance is carried forward, a longer repayment results in greater finance charges.

What is the relationship of the interest rate and the total finance charges?

Higher interest rates increase the total finance charges on unpaid balances.