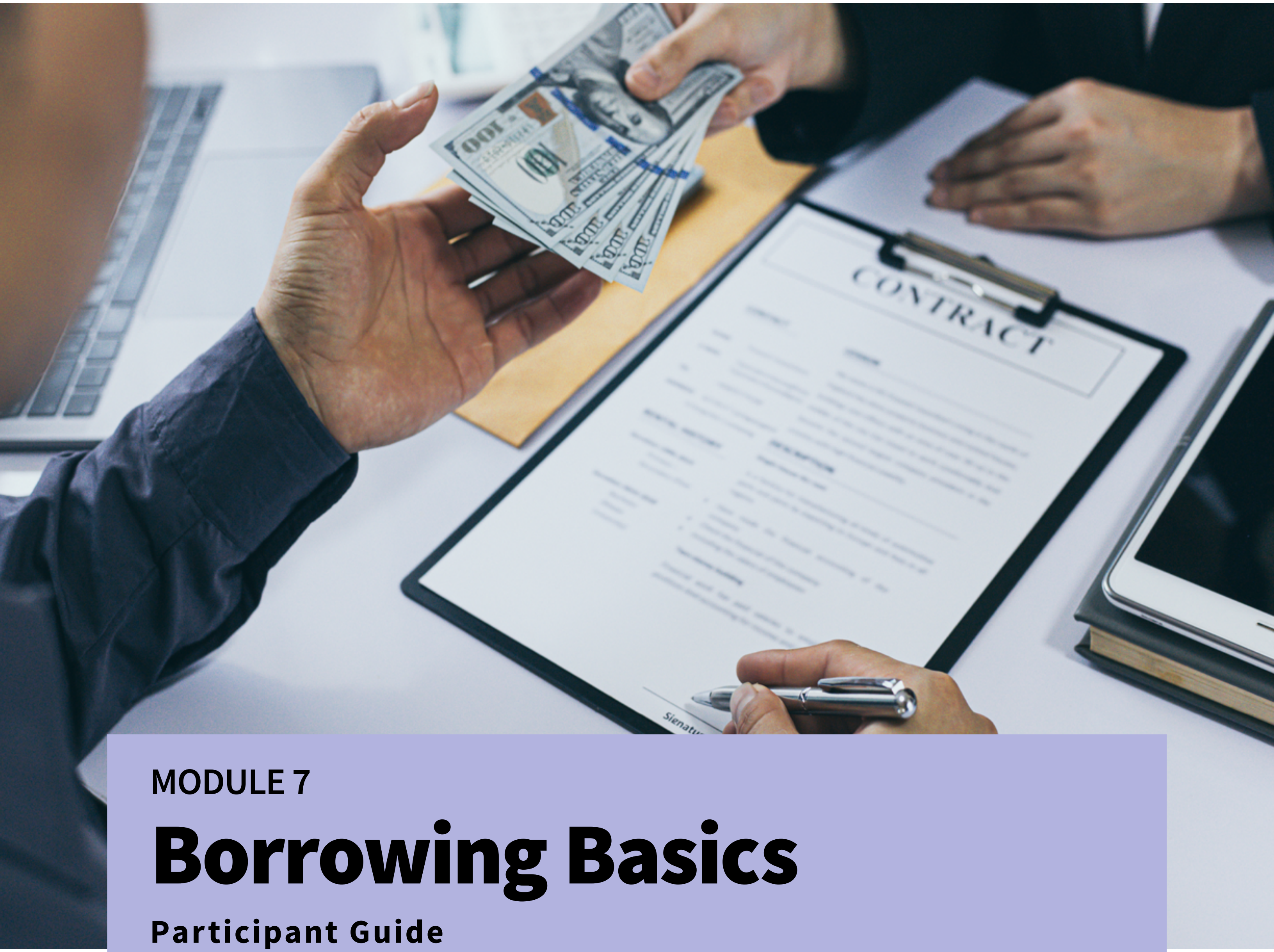
# MONEY SMART FOR YOUNG ADULTS




MODULE 7

# Borrowing Basics

**Participant Guide**

FDIC
FEDERAL DEPOSIT INSURANCE CORPORATION

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The Federal Deposit Insurance Corporation is an independent agency created by Congress to maintain stability and public confidence in the nation's financial system. One way we do that is by providing free, non-biased financial education materials, including this participant guide. For more information about our family of Money Smart products, visit **fdic.gov/moneysmart**.

# Contents

# WELCOME

Welcome to the FDIC's Money Smart for Young Adults!

This is the participant guide for **Module 7: Borrowing Basics.** Use it during and after training. You can write in it. It is yours to keep.

## Module Purpose

This module will help you understand options for borrowing money and what they cost. By the end of this module, you will be able to:

- Define types of loans
- Distinguish between secured and unsecured loans
- List costs associated with borrowing money
- Compare loan offers, including using Truth in Lending Act (TILA) disclosures
- List factors lenders may use to evaluate loan applications
- Identify ways to improve how lenders might evaluate you as a loan applicant
- Distinguish between co-borrowing and co-signing and know important facts and risks related to each
- List responsibilities of people helping you manage your money
- Know what to discuss with the person helping you

**SECTION 1:**

# Ways to Borrow Money and What It Costs

We will discuss different types of loans and the costs of borrowing.

KEY TAKEAWAY:

**Be sure you can afford the payments before getting a loan. Also, know how much it costs and what happens if you can't pay it back.**

## What Borrowing Means

When you borrow, a lender provides you money and you have to pay it back—usually with interest.

**Credit** = The Ability to Borrow Money

**Debt** = Money You Owe a Person or Business

## Types of Loans

An **installment loan** is typically repaid in equal payments for a specific period, usually several years. A **buy now, pay later** loan is a type of installment loan made at the time of purchase.

A **revolving loan** allows unlimited purchases up to a preapproved dollar limit. Payments vary based on how much you borrowed.

There are other ways to purchase items. These options typically are not loans. For example:

- 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, your rental payments are partly credited toward the purchase price.
- Buying on layaway involves putting down a deposit—usually a percentage of the purchase price—and paying the balance (which usually includes fees) over time. You take the merchandise only when you have paid in full. Be sure you understand the refund policy.
- "Buy now, pay later" offers are loans. You borrow money at the time of purchase. You receive the item now and repay the loan in installments. Before using this option, understand the terms, including the interest rate, fees, and consequences of late or missed payments.

# Secured and Unsecured Loans

**Secured loans** require collateral. You pledge collateral to support repayment of the loan.

**Collateral** is an asset you own, such as your house, vehicle, or cash. If you cannot repay the loan as agreed, the lender can take your collateral and use it to get some or all of their money back.

**Unsecured loans** are based only on your promise to repay the money you borrow. They do not use collateral.

# The Cost of Borrowing

The amount you repay on a loan is generally greater than the amount you borrow.

| | |
|---|---|
| **Principal** | Amount of money you borrow |
| **Interest** | Amount of money a financial institution charges for allowing you to use its money—expressed as a percentage |
| **Fees** | May be charged by financial institutions for certain activities, such as reviewing your loan application or servicing the account |
| **Prepayment** | Early repayment of all or part of a loan—when you shop around for a loan, find out if a fee could be charged for prepayment (called a prepayment penalty) |



**TRY IT:**

# Exploring Borrowing Options

Read the scenario and answer the questions.

**SCENARIO:**

## Binh Explores Her Options for Buying New Furniture

Binh recently completed an apprenticeship program and started a new job. The commute from her parents' house is long and she saved enough money for a security deposit to move into her first apartment. However, between paying the security deposit, first month's rent, and utility deposits, she has only $1,500 left over to buy any furniture.

Earlier this week, she saw a full living room set for sale she really likes and thinks will fit perfectly. It costs $2,500.

Yesterday Binh explored options for buying the furniture and learned:

- **She could get a 36-month unsecured installment loan for $1,000 from her local bank.** The furniture would be delivered the day after she makes the purchase. When she adds up the loan amount with interest, plus the $1,500 she pays from her savings, she realizes she will pay $2,636 for the furniture. And, she would be in debt for three years, making monthly payments of about $32.
- **She could keep her savings for an emergency and instead buy the furniture using her credit card.** The furniture would be delivered the day after she makes the purchase. Her credit limit is high enough. With this option, she estimates she will pay at least $3,000 for the furniture. That includes the interest she'll pay the credit card company since she won't pay off the balance right away. Her credit card payments would be about $83 each month for three years.
- **She could purchase the furniture on layaway.** The store says purchasing the furniture this way would cost $2,750. But she won't get to bring home the furniture until she's paid $229 each month for 12 months.
- **She could use a rent-to-own option.** The same living room set is available for next-day delivery from a local store. When she adds up the payments and fees for its rent-to-own option, she learns she will pay $3,500 for the furniture. She estimates that she'll pay $292 each month for 12 months with this option.

| Which options allow Binh to get the furniture soon? |
| --- |
| |

| Which option does not allow Binh to get the furniture today? |
| --- |
| |

| |
|---|
| **Which option results in Binh paying the most money for the furniture?** |

| |
|---|
| **Which option results in Binh paying the least money for the furniture?** |

| |
|---|
| **Some months, Binh has just enough income to cover her expenses. Which options would help her manage cash flow?** |

| |
|---|
| **What else could Binh consider?** |

# Truth in Lending/Comparing Offers

The federal Truth in Lending Act, or TILA, requires lenders to give prospective borrowers a written disclosure (called a TILA disclosure) that states the loan terms in a clear and uniform manner. You receive the TILA disclosure before you sign for the loan.

**Part of a Sample TILA Disclosure for an Installment Loan**

| Annual Percentage Rate | Finance Charge | Amount Financed | Total of Payments |
|---|---|---|---|
| The cost of your credit as a yearly rate. | The dollar amount the credit will cost (interest and fees) over the life of the loan if you make every payment when due. | The dollar amount of credit provided to you. | The amount you will have paid at the end of the loan (including the principal amount and all finance charges) if you make all payments when due. |
| 12% | $600 | $5,000 | $5,600 |

The disclosure you receive for a mortgage (home loan) or some student loans will look different.

Use the TILA disclosures, in particular the annual percentage rates, to compare loan options.

Visit **consumerfinance.gov** and search for "compare loans" to find tools to help you compare loans.

You can also seek help from a housing counseling agency approved by the U.S. Department of Housing and Urban Development or a credit counseling organization.

**Remember the Key Takeaway**

**"Be sure you can afford the payments before getting a loan. Also, know how much it costs and what happens if you can't pay it back."**

**SECTION 2:**

# Preparing to Apply for a Loan

We will discuss how to borrow money and how lenders decide whether to loan money.

KEY TAKEAWAY:

**Learning what lenders look for helps prepare you to apply for a loan.**

## Factors Lenders May Use in Their Decisions

Each lender has its own method for determining whether you are a good credit risk.

You can take notes from the discussion here.

| **Your credit history: How you have paid your bills or debts** |
| --- |
| |

| **Your capacity: Your present and future ability to meet your payments** |
| --- |
| |

| **Your capital: The value of your assets and your net worth** |
| --- |
| |

| Net Worth = Your Assets – Your Liabilities |
| --- |
| |

| Your collateral (for secured loans only): The assets that secure the loan |
| --- |
| |

| Conditions: Other factors that affect getting the loan |
| --- |
| |

## TRY IT:

# Getting Ready to Borrow

Read the scenario and complete the table.

**SCENARIO:**

### Shandra Gets Ready to Borrow

Shandra is thinking about modifying her van so her partner can more easily ride in it. They hire wheelchair-accessible taxis for his transportation.

As soon as Shandra turned 18, she borrowed money to buy a car. At the same time, she applied for and began using a credit card. About a year later, she fell behind on paying bills. The car was repossessed and she missed payments on her credit card several times.

Shandra has worked hard since to stabilize her finances. She paid off the credit card debt and canceled the card. For four years, she has not had any debt while she saved money. She purchased her used van in cash.

Shandra has been in the same job for two years and plans to stay there. She lives with her partner and they share expenses evenly.

She would like to modify her van soon, but can wait if she needs to. She can pay for part of the van modifications using cash she has saved for that purpose. If her preliminary research into financing options is accurate, she thinks she can afford the loan payments for the rest of the modifications.

Shandra promised herself she would save money every time she received income. And she has been doing that. Her emergency fund in a savings account covers her living expenses for about one week. She is proud of how much she has saved.

**Questions**

| What will reflect positively on Shandra? Explain how. |
| --- |
| ☐ **Capacity** |
| ☐ **Capital** |
| ☐ **Credit History** |

| **What will reflect negatively on Shandra? Explain how.** |
|---|
| ☐ **Capacity** |
| ☐ **Capital** |
| ☐ **Credit History** |

| **What can Shandra do to improve her chances of being approved for the loan? Explain how.** |
|---|
| ☐ **Capacity** |
| ☐ **Capital** |
| ☐ **Credit History** |

## APPLY IT:

# Getting Myself Ready to Borrow

To get yourself ready to borrow, pretend you are a lender. Would you approve yourself for a loan?

Complete this worksheet to see how a lender might evaluate your creditworthiness. Then think about what you can do to improve that evaluation before applying for a loan. Also, think about how you will manage a loan if your application is approved.

**What will reflect positively on me?**

- ☐ **Capacity**
- ☐ **Capital**
- ☐ **Credit History**
- ☐ **Collateral** (for secured loans only)

**What will reflect negatively on me?**

- ☐ **Capacity**
- ☐ **Capital**
- ☐ **Credit History**
- ☐ **Collateral** (for secured loans only)

| **What can I do to become a stronger applicant?** |
|---|
| ☐ **Capacity** |
| ☐ **Capital** |
| ☐ **Credit History** |
| ☐ **Collateral** (for secured loans only) |

| **What can I do to improve my credit?** |
|---|
| |

| **How will I make payments on a loan if I'm approved? For example, will I have payments automatically taken out of my account or will I remember to write a check and mail it in each month?** |
|---|
| |

| **How will I monitor the loan? For example, will I receive paper statements or monitor my payments and balance online? Or both?** |
|---|
| |

# Co-Borrowing and Co-Signing

**Co-borrowing** is taking out a loan jointly with one or more people.

- Each co-borrower is responsible for repaying the debt. Payment history appears on the credit reports of each co-borrower.
- Before you co-borrow, have a clear agreement with the other co-borrowers about how much of the loan payment each will pay and other responsibilities.

**Co-signing** is taking full responsibility for paying back a loan, along with the primary borrower. The loan proceeds go to the borrower and not to the co-signer. When you co-sign, you promise to pay the debt if the borrower does not.

**APPLY IT:**

# My Tip Sheet for Considering Co-Signing Someone Else's Loan

Review this tip sheet if you are considering co-signing someone's loan.

**Questions to Ask Yourself Before Co-Signing**

- [ ] **Can I afford to pay the loan?**
  Consider the worst-case scenario—the borrower does not make the payments and you have to make them and possibly also pay late fees and collection costs.

- [ ] **Will co-signing affect my ability to get the credit I need?**
  When you co-sign, the debt appears on your credit report. If this debt is ever in default, it may become part of your credit history and affect your credit scores.

  Also, to get other credit, lenders may consider the co-signed loan as one of your debts when determining your capacity to take on new debts.

- [ ] **Do I understand how much money I might I have to repay?**
  Ask the lender to calculate the amount you might owe. You also may be able to negotiate specific terms of your obligation.

  For example, limit your liability to the loan's principal. If you do—before you co-sign—ask the lender to include a statement in the contract. The statement could say: "The co-signer will be responsible only for the principal balance on this loan at the time of default." While that is better for you, it could mean the lender will not approve the borrower for the loan.

- [ ] **Do I understand what I might lose?**
  If—besides co-signing—you offer items you own as collateral for the loan, understand that you may lose those items. Before you pledge property—like your car—to secure the loan, consider the risk. If the borrower defaults and you cannot pay the debt, you could lose that property.

**Ways to Protect Yourself as a Co-Signer**

- [ ] **Get notified.**
  Ask the lender to notify you if the borrower misses a payment or the loan terms change. Get the lender's agreement to do so in writing before you co-sign. That gives you time to address the problem or make payments without having to repay the entire amount immediately.

- [ ] **Get copies.**
  Get copies of all important papers, like the loan contract and the TILA disclosure. These documents may be useful if there's a dispute. The lender may not be required to give you these papers, so you may have to get copies from the borrower.

Check with your state attorney general's office for rights of co-signers in your state. You can also search "loan co-signer" at **usa.gov**.

**Remember the Key Takeaway**

> **"Learning what lenders look for helps prepare you to apply for a loan."**

**SECTION 3:**

# Borrowing When Someone Helps You Manage Your Money

We will discuss borrowing money when someone helps you manage your money.

KEY TAKEAWAY:

**Even if someone helps you manage your money, understand the terms of a loan before you commit to it.**

## Responsibilities of the Person Helping You

When someone helps you with your finances, they must:

- Act in your best interest.
- Manage your money and property carefully.
- Keep your money and property separate from theirs.
- Keep good records.
- Include you in decision-making to the extent possible.

Find guides specifically for people who help other people with their money by visiting **consumerfinance.gov** and searching for "someone else's money."

## What to Discuss

You may want to discuss these questions with the person who helps you with your finances and a trusted advisor. It's okay if the people helping you with your money also help you answer these questions. You don't need to know all the answers yourself.

- Why do you want or need to borrow money?
- Do you have enough money to repay the loan?
- How will you make payments on the loan?
- How will you monitor the loan?
- Will borrowing money affect any of your sources of income?
- What is the best borrowing option for your needs?

# If You Decide to Borrow Money

Understand the loan terms before you commit to it. You should know:

**How much money you are borrowing.**

**How much money you have to pay back in total.**

**How much money you have to pay each month.**

**When payments are due.**

Get help considering the loans terms and completing the application. A lender cannot disqualify you because you need help.

The lender decides if you are a good credit risk, just as they would any other potential borrower. The lender does not consider the creditworthiness of the person helping you unless that person is a co-signer or co-borrower.

## After you borrow money, you need to:

**Repay the loan.**

**Always make payments on time.**

**Keep good records.**

**Remember the Key Takeaway**

> **"Even if someone helps you manage your money, understand the loan terms before you commit to it."**

# MODULE CLOSING

## Remember the Key Takeaways

| SECTION | KEY TAKEAWAY |
|---|---|
| **1: Ways to Borrow Money and What It Costs** | Be sure you can afford the payments before getting a loan. Also, know how much it costs and what happens if you can't pay it back. |
| **2: Preparing to Apply for a Loan** | Learning what lenders look for helps prepare you to apply for a loan. |
| **3: Borrowing When Someone Helps You Manage Your Money** | Even if someone helps you manage your money, understand the loan terms before you commit to it. |

## Take Action

You are more likely to act if you commit to **taking action now.** One way to commit is to think about what you plan to do because of what you learned today. Then write it down.

**What will I do?**

**How will I do it?**

**Will I share my plans with anyone? If so, who?**

# Where to Get More Information or Help

The Consumer Financial Protection Bureau offers numerous tools to help consumers thinking about borrowing money wisely. Visit **consumerfinance.gov** and search for “borrowing money.”

The Federal Trade Commission has information about a range of related topics, including scams to watch out for and consumer protections, at **consumer.ftc.gov/topics/credit-and-loans**.

If you have a question about a banking product, ask a customer service representative at the financial institution for help.

If you have a concern, explain to the customer service representative what happened and what you would like them to do to correct the situation. If that does not help, consider contacting the federal regulator for that financial institution.

To find out who regulates the financial institution, call the FDIC toll-free at 1-877-ASK-FDIC (1-877-275-3342) or visit **fdic.gov/consumers/assistance/filecomplaint.html**.

# Pre-Training Survey

Your instructor may ask you to complete this pre-training survey.

Please answer these questions:

1. You can increase your chances of being approved for a loan by improving which of these? (Choose all that apply.)
    a. Your capacity
    b. Your capital gains
    c. Your credit history
    d. Your creditors
    e. All of the above

2. Most loans are set up the same, so it is not important to shop around.

    ☐ True ☐ False

3. Federal Truth in Lending Act or TILA disclosures can help you compare loan options from different lenders.

    ☐ True ☐ False

4. If someone helps you manage your money, you are not eligible to borrow money.

    ☐ True ☐ False

# Post-Training Survey

Your instructor may ask you to complete this post-training survey.

Please answer these questions:

1. You can increase your chances of being approved for a loan by improving which of these? (Choose all that apply.)
   a. Your capacity
   b. Your capital gains
   c. Your credit history
   d. Your creditors
   e. All of the above

2. Most loans are set up the same, so it is not important to shop around.

   ☐ True ☐ False

3. Federal Truth in Lending Act or TILA disclosures can help you compare loan options from different lenders.

   ☐ True ☐ False

4. If someone helps you manage your money, you are not eligible to borrow money.

   ☐ True ☐ False

## About the Training

Please answer the following questions about the training.

1. The trainer:

| | | |
|---|---|---|
| Shared information in a way that was clear and easy to understand. | ☐ Yes | ☐ No |
| Made the training engaging. | ☐ Yes | ☐ No |
| Encouraged participation and discussion. | ☐ Yes | ☐ No |
| Showed respect for all participants. | ☐ Yes | ☐ No |
| Created a good learning environment. | ☐ Yes | ☐ No |

2. Do you feel better able to make decisions related to the topic of this training?

   ☐ True ☐ False ☐ I do not know

3. Did the training provide information that you can use immediately?

   ☐ True ☐ False ☐ I do not know

4. What were strengths of the training materials?

   What could be improved?

5. What were strengths of how the instructor led the training?

   What could be improved?

6. What else would you like to learn about this topic or other money topics?