Activity 1

DEBT AND CREDIT

PART 1

Imagine that you need $700 to go on a school-sponsored trip in early September. You have $400 in savings and ask a classmate to lend you the extra $300. Your classmate will consider lending you the money, but wants to make sure you will pay it back, so he asks you to provide the following information:

- How much money do you earn per week, and how much of that money is already budgeted to other expenses?
- Can you show evidence that you are responsible about paying your bills and debts? For example, have you ever borrowed money before? How quickly did you pay it back? Have you ever made a late payment?
- Are you currently attempting to borrow money from anyone else?

The following chart describes three scenarios for this situation. Mark the items listed for each scenario with a **+** or a **—** to indicate whether they would positively or negatively affect your classmate's decision to lend you the money. Mark an **x** for items that you think are neutral. Then answer the questions below.

SCENARIO A

__You have a part-time job that pays $160 per week.

__Your current expenses are a phone bill of $20 per month and car insurance that is $60 per month.

__Last year, you borrowed $75 from your cousin and repaid it within 2 months.

__Two years ago, you missed a payment on your phone bill, but caught up and have paid all of your other bills on time for the past 3 years.

SCENARIO B

__You have a part-time job that pays $160 per week.

__Your current expenses are a phone bill and car insurance that total $120 per month, plus a credit card with a $2,000 balance.

__Last year you borrowed $75 from your cousin and took 6 months to pay it back.

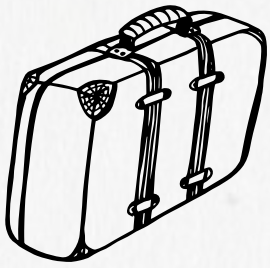
__You typically pay your bills on time, but were more than 30 days late paying your phone bill last month.

SCENARIO C

__You have a part-time job that pays $160 per week.

__You have no current expenses.

__You have no record of having borrowed money or repaid it.

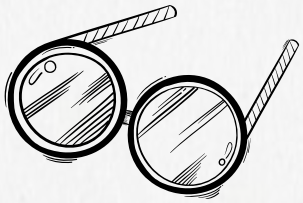


1. In which scenario do you think your classmate would be most likely to lend you the money?

☐ A ☐ B ☐ C

2. Least likely?

☐ A ☐ B ☐ C



Click here to clear answers

PART 2

Let's assume that you fit the profile for scenario A. Your classmate decides to lend you the money under the following terms:

- You have until the end of the year to repay the loan.
- Your interest rate is 2% per month.
- Interest is charged at the beginning of each month before payments are credited.

MONTH	BEGINNING BALANCE	TOTAL MONTHLY PAYMENT	MONTHLY INTEREST PAYMENT	ENDING BALANCE
SEPT.	$300.00	$60.00	$6.00	$246.00
OCT.	$246.00	$160.00	$4.92	$90.92
NOV.	$90.92	$80.00	$1.82	$12.74
DEC.	$12.74		$0.25	$0.00

You think the interest rate is high, but it encourages you to pay your classmate back in a timely manner. The chart above shows your monthly payments.

1. How much will you have to pay in December in order to repay the loan in full? $_____
2. What was the total amount of money you had to pay your classmate by the time you repaid the loan? How much of that was interest?
   Total Paid: $_____Total Interest: $_____
3. How would the cost of this loan be different if interest were calculated at the end of each month, after the month's payments had been credited?

_____

PART 3

Now, suppose that, instead of paying as much as you can each month, you decide to pay off the loan in four equal monthly installments. Use the online loan calculator at **tools.finra.org/loan** to find out whether this is a good decision.

1. The loan calculator asks for an annual interest rate. At 2% per month, what is the annual interest rate for your loan? _____%
2. According to the calculator, what is your monthly payment? $_____
3. What is the total amount you will pay? $_____How much of that is interest: $_____
4. Is this a good decision compared to paying as much as you can each month? Why or why not?

_____

PART 4

Let's give the situation one more twist. Your classmate tells you that the interest rate will increase by one percentage point each month. Fill in this chart with the same monthly payments shown in the chart for Part 2. Then answer these questions.

MONTH	BEGINNING BALANCE	MONTHLY INTEREST RATE	TOTAL MONTHLY PAYMENT	MONTHLY INTEREST PAYMENT	ENDING BALANCE
SEPT.	$300.00	2%	$	$	$
OCT.	$246.00	3%	$	$	$
NOV.	$93.38	4%	$	$	$
DEC.	$17.12	5%	$	$	$

1. How much will you have to pay in December in order to repay the loan in full? $_____
2. What is the total amount of money you will pay to your classmate when you have repaid the loan? How much of that is interest?
   Total amount paid: $_____Total interest: $_____
3. How does changing the interest rate each month change the total amount you have to pay over the life of the loan?

_____

_____