

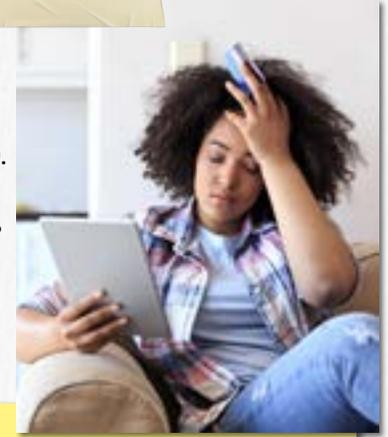
Activity 2

MANAGING DEBT

PART 1: WEIGHING YOUR OPTIONS

Imagine that you have two credit cards: Card A has an APR of 19.99% and a balance of \$5,000. Card B has an APR of 8.99% and a balance of \$7,000. You decide to set aside \$800 per month to pay down the debt on both cards. What is the best way to allocate your monthly payments? Find out by answering the questions below, using this online credit card payoff calculator:

www.creditcards.com/calculators/payoff.



OPTION 1

- If you pay \$400 per month on each card, how long will it take to pay them both off? _____ months
- How much interest would you pay in total?

Interest on Card A \$ _____ + Interest on Card B: \$ _____ = Total Interest: \$ _____

OPTION 2

Let's say that the minimum payment for each card is \$100. You decide to pay off one card at a time, while only making the minimum payment on the other. When the first card is paid off, you will put all of your monthly payments towards paying off the second. Which card should you pay off first? Use this chart and the online calculator to help you work out the math:

	PAY OFF CARD A FIRST	PAY OFF CARD B FIRST
How many months will it take to pay off the first card, if you pay \$700/month?		
How much interest will you have paid on the first card?	\$	\$
What will the balance on the second card be at that time, if you've continued to pay \$100 a month? (Assume interest is compounded monthly.)	\$	\$
How much interest will you have paid on the second card?	\$	\$
How many more months will it take to pay off the second card at that point?		
How much additional interest will you have paid?	\$	\$
	TOTAL MONTHS:	
	TOTAL INTEREST:	\$

Which card would you pay off first and why?

OPTION 3

Now suppose that you receive a balance transfer offer from another credit card company that you can use to pay off both of your current credit cards. The terms are:

- Transfer fee of 3% or \$25 for each transfer, whichever is higher
- No interest for 9 months
- After that, an annual interest rate of 9.99%



1. What would the transfer fee be for each card? Card A: \$_____ Card B: \$_____
2. What would be the balance on this new card if you transfer the balances from both of your current cards plus the combined transfer fees? New balance: \$_____
3. If you continue to pay \$800 per month toward paying off your credit card debt, how long would it take to pay off this new card? Remember that you will pay no interest for the first 9 months. _____ months
4. What is the total amount you would pay in interest and fees? \$_____
5. Comparing these three options, which do you think is the most financially responsible plan of action? Why?

PART 2: LOAN CONSOLIDATION

Now imagine that you have two loans, in addition to the credit card debt described in Part 1. You pay \$320 per month toward an auto loan, which has a current balance of \$15,000 and an interest rate of 7%. You also pay \$100 per month toward a furniture purchase that you financed at an interest rate of 1.9%, which has an unpaid balance of \$1,000.

1. What is your total debt, including credit card debt? \$_____
2. What are your total monthly debt payments, assuming that you chose Option 1 above to manage your credit card debt? \$_____
3. If your net monthly income is \$4,000, what percentage of this income is going toward monthly debt payments? _____%

You apply for a consolidation loan to help pay off your debt. The new loan, for \$28,000, has an annual interest rate of 6% and your new monthly payment is \$350. Answer the questions below using the loan consolidation calculator at

www.bankrate.com/calculators/credit-cards/credit-card-loan-consolidation-calculator.aspx.

4. How long will it take you to pay off the loan? _____
5. What is the total amount you will pay on the loan, including principal and interest? \$_____
6. How much less will you spend each month on debt payments? \$_____
7. Assume that you put this extra money each month into a retirement fund earning 5% interest per year. What is your investment worth by the time you pay off the loan? Use the calculator at www.investor.gov/additional-resources/free-financial-planning-tools/compound-interest-calculator to find out \$_____
8. Was the consolidation loan a smart financial decision? Why or why not?
