TYPES AND COST OF CREDIT

Pit Stop Summary: This Pit Stop educates students on the different types of credit and the costs associated with borrowing money.

Navigation Tips:

Understand the types of credit and the cost of borrowing

Test Drive Overview:

(Estimated Time: 20 min)

Students play Budget Challenge Loan Trivia (a Jeopardy-style game) to demonstrate knowledge of loan and credit terminology. Teachers should distribute copies of the Test Drive, so students can read through the rules and track categories. The game starts once the teams are established and roles have been assigned. Use the (Trivia PowerPoint) in slideshow mode to project the game board.

Did You Know?

A high credit score can lead to a lower interest rate when borrowing money.

Budget Challenge® Road Test for Personal Finance® — Rubber Meets the Road:

During the simulation, students manage three different types of debt: a credit card (unsecured debt), student loan (government subsidized debt) and an automobile loan (secured debt).

Navigation Tip #1: Borrowing money costs money. Different types of loans have different kinds of terms.

Unsecured Debt - Credit Card

- Credit cards usually have a variable (or floating) interest rate in which the APR (annual percentage rate) can change.
- Typically the rate is tied to another rate called an index.
- In the U.S., most credit cards are pegged to the prime rate.
- The prime rate moves with the interest rate set by the Federal Reserve called the federal funds rate.
- When you hear "the Fed raised interest rates," it means the cost of carrying a balance on your credit card most likely went up.

In Budget Challenge, Surge Credit Card offers two options with different fixed finance rates. Students are not able to increase their credit or decrease the interest rate. Finance fees are assessed for carrying a balance and on cash advances. Surge has a minimum finance fee of $2 per month.

Secured Debt – Consumer Asset Loans

- Most collateralized consumer loans have a fixed simple interest rate.
- A collateralized loan is backed by the value of the asset it finances.
- If the borrower defaults on the loan, it could result in a repossession, which has a significant negative impact on credit score.
- The bank owns the asset (holds the lien) until the loan is paid in full.
- Because the loan has collateral, the rate is usually lower than unsecured debt.

In Budget Challenge, Zippy's Auto Loan offers two different types of automobile loan options: credit union and a bank loan. Students select an option during vendor selections and must repay the loan they selected according to its terms. In real life, credit unions and banks are separate institutions. In the game, we have both housed within the same category merely to illustrate 2 different kinds of auto-loans.

Terminology Tune-Up:

Principal: Amount of money borrowed.

Interest rate: Money charged by the lender for the amount borrowed, expressed as an annual percentage.

Term (Periods): Amount of time allotted for repayment of a loan.

Secured Credit: Credit backed by collateral.

Unsecured Credit: Credit not backed by collateral.

Collateral: Asset assigned as security for a loan.

Lien: Legal claim to the property of borrower to secure the payment of a debt or the satisfaction of an obligation.

Extended Learning Topics:

- Paying down the most expensive debt
- Prepayment penalties

The Test Drive Necessities: Test Drive- Loan Trivia I Trivia PPT

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Subsidized Loans

- Most subsidized (or government-backed) student loans offer deferral of interest during college and a six month non-payment period for up to six months after graduation.
- The rate on a subsidized loan is usually much lower than that of an unsubsidized loan.
- The interest on student loans is usually compounded monthly and added to the principal of the loan.
- Unlike most debt, student loans are not forgiven in bankruptcy.

When the simulation starts, students have been employed for at least six months and their student loan from Riptide Student Loans is now in repayment. The student loan is a monthly bill.