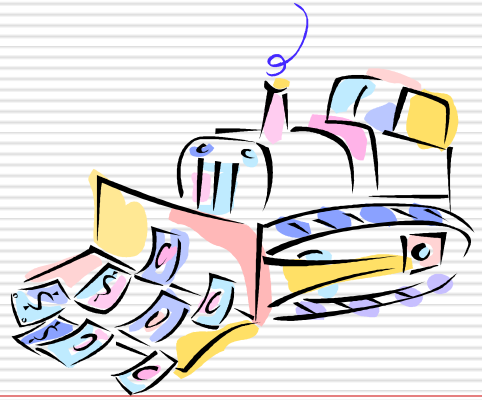
5-2
Problems with Credit: Credit Overload

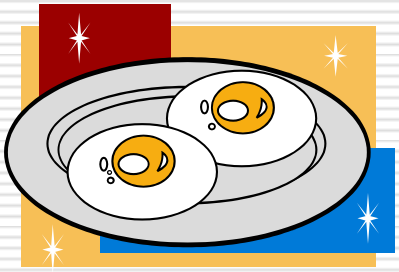
Ask Yourself

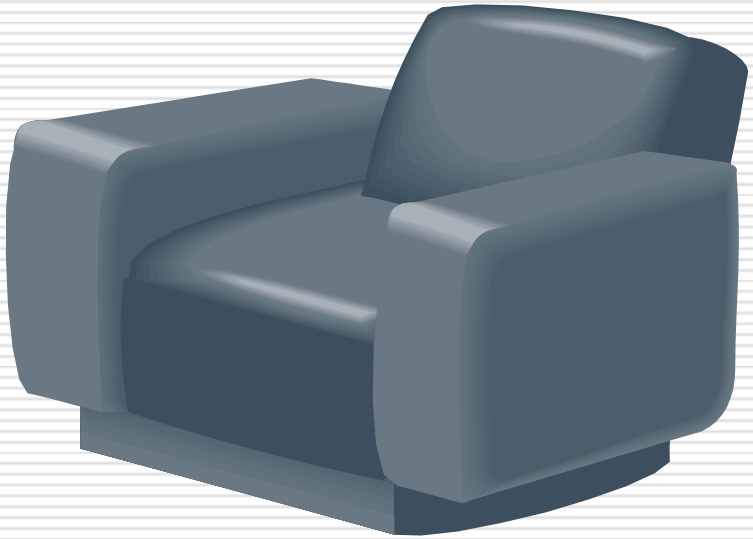
- Pg 198
  - What are three problems with using credit?
    - Borrowers pay heavily for the privilege of using credit; credit ties up future income; credit makes it easy to overspend.



- What are four indicators that a borrower is experiencing credit overload?
  - Missed installment payments; can only make minimum payments; receive overdue notices; little to no savings.

- Why is it easy to borrow too much money?
  - It is a deceptively easy way to get what you want.





- To make payments on a loan is to **amortize** the loan.

- The total cost of a loan:
  - is the amount of interest paid over the term of the loan.

Total cost = total payment – original loan amt

Skill 1

In Example 3 of 5-1 Taylor Swift considered loans of $4100, $5250, $6450, and $8375.

Does the cost of financing a loan increase or decrease as the term of the loan increases?

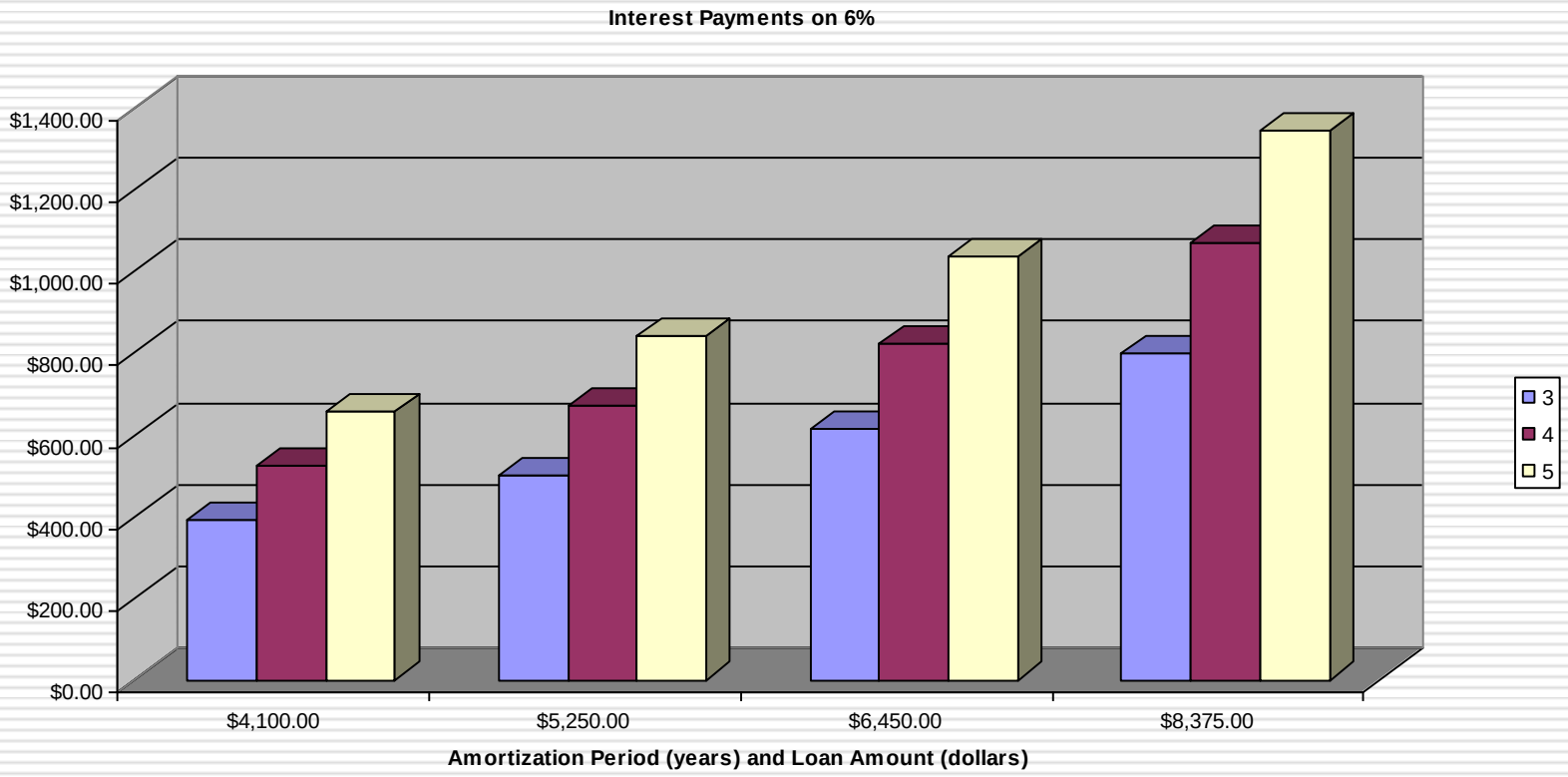
Loan Amount	Number of Years	Monthly Payment	Total Payment
$4,100.00	3	$124.73	$4,490.28
$4,100.00	4	$96.29	$4,621.85
$4,100.00	5	$79.26	$4,755.87
$5,250.00	3	$159.72	$5,749.75
$5,250.00	4	$123.30	$5,918.23
$5,250.00	5	$101.50	$6,089.83
$6,450.00	3	$196.22	$7,063.97
$6,450.00	4	$151.48	$7,270.96
$6,450.00	5	$124.70	$7,481.79
$8,375.00	3	$254.78	$9,172.21
$8,375.00	4	$196.69	$9,440.98
$8,375.00	5	$161.91	$9,714.73

- **As the term of the loan gets longer, her payments get smaller, and total payment gets larger.**

How do we find total cost?

Loan Amount	Number of Years	Monthly Payment	Total Payment	Total cost
$4,100.00	3	$124.73	$4,490.28	$390.28
$4,100.00	4	$96.29	$4,621.85	$521.85
$4,100.00	5	$79.26	$4,755.87	$655.87
$5,250.00	3	$159.72	$5,749.75	$499.75
$5,250.00	4	$123.30	$5,918.23	$668.23
$5,250.00	5	$101.50	$6,089.83	$839.83
$6,450.00	3	$196.22	$7,063.97	$613.97
$6,450.00	4	$151.48	$7,270.96	$820.96
$6,450.00	5	$124.70	$7,481.79	$1,031.79
$8,375.00	3	$254.78	$9,172.21	$797.21
$8,375.00	4	$196.69	$9,440.98	$1,065.98
$8,375.00	5	$161.91	$9,714.73	$1,339.73

The following chart represents the relationship between amortization periods of 3, 4, and 5 years and interest payments.



- Ashley Green points out to Taylor that she can buy a car priced at $6450 or a car priced at $8375 for a monthly payment of approximately $196.
- Should Taylor buy the more expensive car without further investigation, since it appears to cost the same amount of money on a monthly basis?
- What other factors should she take into account?

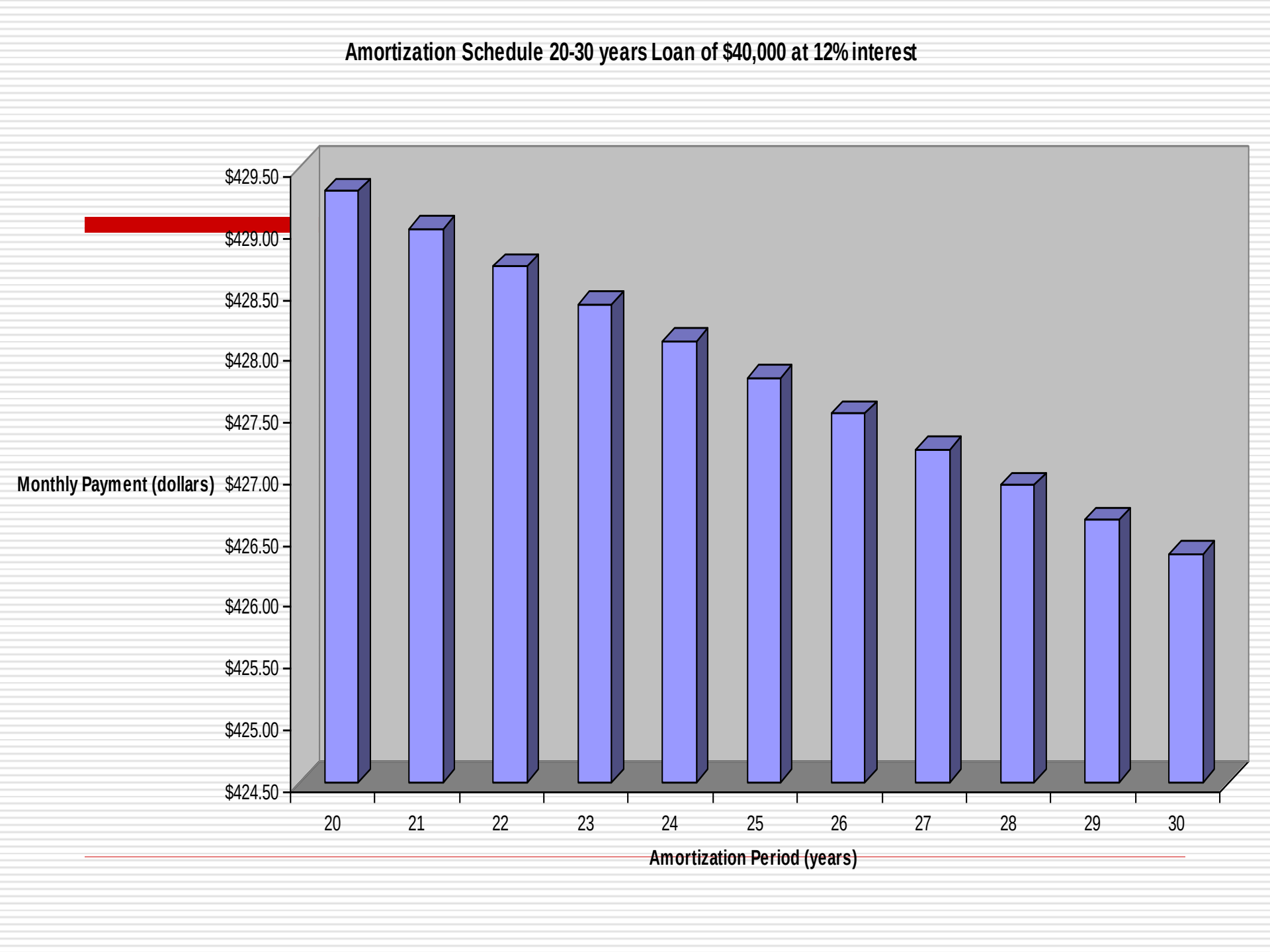
- No, she should not buy the more expensive car without further investigation.
- She should consider the total cost of each loan. She will be paying for the more expensive car for 5 years instead of three.
- The total cost of the expensive car is $1,339.73, compared to $613.97.

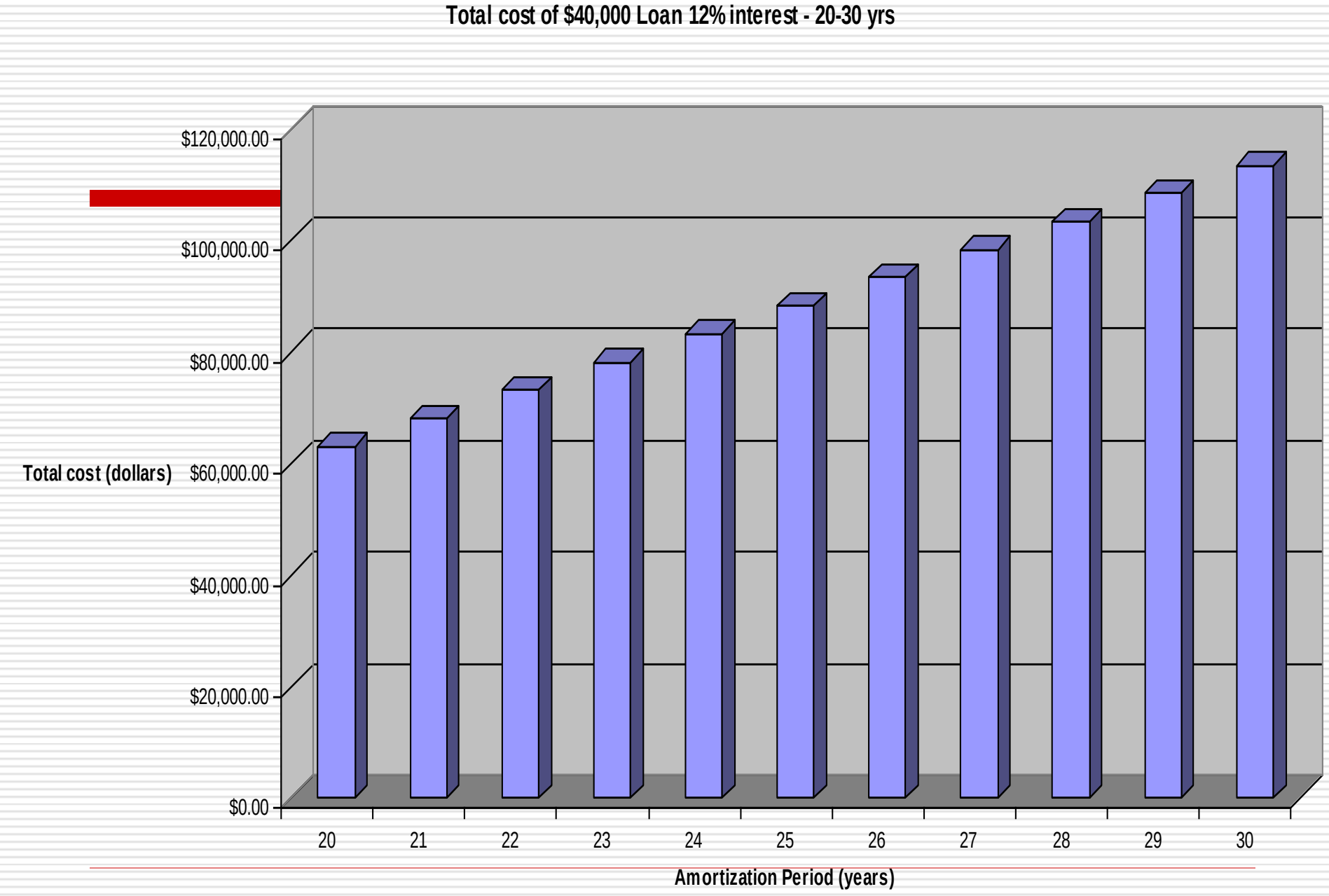
Skill 3

- Is an amortization period of 30 years better than 20 years? The loan is for $40,000 at 12% annual interest rate.

Skill 3

- Is an amortization period of 30 years better than 20 years? The loan is for $40,000 at 12% annual interest rate.
- Lets create a spreadsheet to show monthly payments, total payments, and total costs for amortization periods of 20-30 years.


Amortization Schedule 20-30 years Loan of $40,000 at 12% interest
$429.50
$429.00
$428.50
$428.00
$427.50
$427.00
$426.50
$426.00
$425.50
$425.00
$424.50
Monthly Payment (dollars)
20
21
22
23
24
25
26
27
28
29
30
Amortization Period (years)


Total cost of $40,000 Loan 12% interest - 20-30 yrs
$120,000.00
$100,000.00
$80,000.00
$60,000.00
$40,000.00
$20,000.00
$0.00
Total cost (dollars)
20
21
22
23
24
25
26
27
28
29
30
Amortization Period (years)

- What do you notice about the correlation between total cost and the amortization period?

  - As the total cost increases so does the amortization period.
  - Before applying for any type of mortgage one should consider all options.

assignment

P203 tys

1-13