

# Got Money?

The Low-Down on  
Loans, Interest and  
Keeping Your Head  
Above Water



## Message to the Participant

As a community service, U. S. Bank has developed a series of learning modules to assist you in gaining an understanding of various banking and financial-related services, processes and concepts.

This module's objectives are:

- Understanding the Different Types of Loans
- Learning the Basics of How to Qualify for a Loan
- Understanding the Different Types of Interest

Typically, each of these sessions will last approximately one hour. Please feel free to ask questions throughout and to call upon your facilitator at a later date should you have further questions.

U. S. Bank strives to foster a strong relationship within every community in which U. S. Bank is fortunate enough to do business.

We hope you find this learning experience enlightening and helpful in your efforts to gain more knowledge about the financial world.





## Types of Loans

### Key Types of Lending Agreements

- \* **Revolving Agreement.** A consumer pays in full each month or chooses to make a partial payment based on the outstanding balance. Interest charges apply to unpaid balances. Department stores, gas and oil companies, and banks typically issue credit cards based on a revolving credit plan.
  - Visa<sup>®</sup>
  - MasterCard<sup>®</sup>
  - Discover<sup>®</sup>
  - Optima<sup>®</sup>
  - Department Store
  - Gas
  - Home Equity Line of Credit
  
- \* **Charge Agreement.** A consumer promises to pay the full balance each month, so the borrower does not have to pay interest charges. Charge cards, not credit cards, and charge accounts with local businesses often require repayment on this basis.
  - American Express
  
- \* **Installment Agreement.** A consumer signs a contract to repay a fixed amount of credit in equal payments over a specific period of time. Automobiles, furniture and major appliances often are financed this way. Personal loans usually are paid back in installments, too.
  - Car Loan
  - Home Mortgage Loan
  - Home Equity Loan

### Key Lending Channels

- \* **Indirect Loans** - Borrower gains a loan or financing generally through a retailer who completes all of the documents and then works with a bank or other financial institution to secure the loan.
  
- \* **Direct Loans** - Borrower secures a loan by applying directly with a bank or other financial institution.





# Common Loans

## **Auto**

- Obtained as either a direct or indirect loan
- Has a fixed or variable rate of interest. A fixed rate of interest works just the way it sounds. It means that the interest rate will remain the same for the duration of your loan. A variable interest rate means your interest rate could go up and down during the term or your loan.
- Generally maximum term is 5 years or 60 months
- Auto is used as collateral and may be repossessed in case of default

## **Student**

- Depending on your school, it may be a direct or indirect loan
- Has a variable rate of interest.
- Usually, the maximum term is 10 years

## **Home Mortgage**

- Obtained as direct loans through a bank or a financial institution
- May have fixed or variable rate of interest.
- Generally 15-year or 30-year term
- Property is used as collateral in case of default

## **Home Equity Loan**

- Money is borrowed on the amount you have already paid on the principal of your home mortgage loan
- Property is used as collateral in case of default
- Fixed amount of money repayable over a fixed timeframe
- Home equity loan might be considered if you need a set amount for a specific purpose, such as an addition to your home.

## **Home Equity Line of Credit**

- Form of revolving credit
- Property is used as collateral in case of default
- You are approved for a certain amount of credit, much like a credit card
- Credit limit is set by taking a percentage (say, 75%) of the appraised value of the home and subtracting the balance on the existing mortgage. For example:  
Appraisal of home: \$100,000  
Percentage of appraised value: \$75,000 ( $\$100,000 \times 75\%$ )  
Less mortgage debt of \$40,000  
Potential credit line: \$35,000



# Student Loan Basics

## Two Types of Financial Aid

### Need based aid

- determined based on your family's financial situation using a needs analysis application: Federal Student Aid (FASFA)

### Non-Need based aid

- awarded to students showing special achievements or talents or meeting other requirements (such as: academic, athletic, returning adult or leadership scholarship)

## Applying for Student Financial Aid

- Complete and submit a FASFA early!
- Become very familiar with the different U.S. Government Federal Funding for students:
  - ✓ Federal Pell Grant - Awarded to part-time and full-time undergraduate students who show financial need. Like all grants, the Federal Pell Grant does not have to be repaid.
  - ✓ Federal Supplemental Educational Opportunity Grant - This federal grant program is a supplement to Federal Pell Grants. Funds are limited, so apply early.
  - ✓ Federal Work Study - This federal program gives you the opportunity to earn money for school and gain invaluable work experience. It's available to both undergraduate and graduate students with financial need. The amount you can earn depends on several factors: need, other aid received, and availability of school funds.
  - ✓ Federal Education Loans - These federal loan programs allow you or your parents to borrow money either through a bank or directly through the government. These low-interest loan programs include Federal Perkins Loans (student), Federal Stafford Loans (student), and Federal PLUS Loans (parents).

## Student Loan Tips

1. Don't assume that your income makes you ineligible for financial aid. You may be surprised to see what's available. Apply for every financial aid choice available.
2. Complete and submit a Free Application for Federal Student Aid (FAFSA) early! Most financial aid is awarded on a first-come, first-served basis. You should submit your application in January or February for the fall year.
3. Call your school's financial aid office for their application deadlines.
4. Keep a copy of every form you complete.
5. Record the dates on which you submitted forms and note the names of everyone with whom you spoke.
6. Remember to re-apply for financial aid each year.





# Loan Terminology

## **Annual Percentage Rate (APR)**

A calculation which standardizes rates, points, and other costs of a loan. This figure is disclosed as part of the truth-in-lending statement, which is required by the Federal Truth-In-Lending Act. This rate is likely to be higher than the stated note rate or advertised rate, because it takes into account points and other credit costs, loan discount, origination fees, and other credit costs. The APR allows borrowers to compare different types of loans based on the annual cost for each loan.

## **Borrower**

An individual who receives funds in the form of a loan with an obligation to repay the principal with interest.

## **Co-signer**

Someone who signs a credit agreement along with the borrower who does not receive goods, services or money in return for the obligation. The co-signer is legally obligated to assume responsibility for loan repayment if the borrower doesn't.

## **Collateral**

Anything of value (asset) pledged to a lender until a loan is repaid. Can be seized if the loan is not paid.

## **Deposit**

A sum of money (earnest money) given by the borrower to secure a loan.

## **Fixed Interest Rate**

An interest rate that does not change during the entire term or life of the loan.

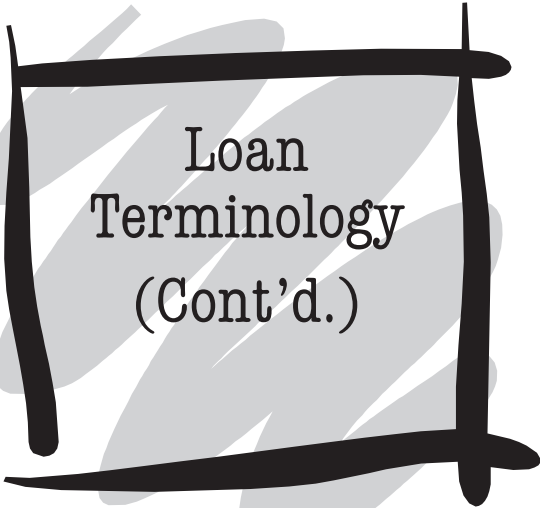
## **Gross Monthly Income**

The total monthly income earned before taxes and any benefit deductions.

## **Interest Rate**

The percentage of an amount of money that is borrowed and is paid for during a specific period of time specified in the terms of the loan.





## Loan Terminology (Cont'd.)

**Loan Balance**

The outstanding balance of a loan not paid in full, excluding any accrued interest.

**Loan Term**

The total number of payments required to pay the loan in full. This is also known as an amortization term.

**Maturity**

The termination or due date on which final payment of a loan must be paid in full.

**Payment Schedule**

A schedule detailing the amount and due date of payments required to be paid over the life of the loan. The dollar figures represent principal and interest. This schedule does not reflect payment for taxes and insurance.


**Pre-qualification**

A request by a prospective loan applicant for a preliminary determination of whether the prospective applicant would likely qualify for credit under a lender's standards, or of the amount of credit for which the prospective applicant likely would qualify. Pre-qualification is generally not a commitment to lend.

**Term**

A period of time (usually months) that a loan must be repaid.





## Qualifying for a Loan

You're ready to apply for a loan, but where do you start? Here's what you'll need to know before you take the plunge.

**Adults only.** In order to apply for a loan by yourself (without a parent or guardian), you must be a legal adult, or 18 years of age.


**Applications, ahoy.** If you're planning on shopping around for various car loans, be prepared to fill out applications. Be sure to have vital information like your Social Security Number, permanent home address, employment history, and checking or savings account information (account numbers and balances) on hand to make the process as easy as possible.

**Regular source of income.** Creditors want to know that you can afford to re-pay the money they're letting you borrow, so it's important to have a steady job when applying for credit. Some lenders may ask for proof of employment, such as a pay stub.

**Good credit history.** If you've never applied for a loan before, you likely don't have a credit history. However, it is always a good idea to check with one of the three major credit reporting agencies before applying for a loan.

**Co-signer.** For those who don't have a credit history, you may need to have a co-signer. A co-signer is someone who is willing to accept responsibility for your debt if you aren't able to pay off the loan.





## How Do I Qualify For a Loan?

How much money a lender will let you borrow will be determined, primarily, by your credit score, or FICO score. This score is a three-digit number between 300 and 850 that gives lenders a quick glimpse of what kind of credit risk you might be. The higher the number, the better off you are.

### What Your Credit Score Is Based On

- 1. Past payment history.** (35%) How quickly you pay your bills weighs heavily on your overall score. Your credit report will indicate whether you are 30, 60, or 90 days or more late with a payment. A history of late payments will damage your score. On the flip side, by paying your bills consistently on time, you can greatly improve your overall score.
- 2. Amounts owed.** (30%) Add up all of your outstanding balances and compare the number to the amount of credit that is available to you. At the same time, you want to make sure that the credit extended to you isn't out of proportion with your income.
- 3. Length of credit history.** (15%) Obviously, the longer you've had credit established, the better you'll look in the eyes of a lender. Your score is also determined by how long you've had individual accounts as well as how long it's been since you've used that account. Don't open multiple new accounts in the hopes of building credit quickly, however. This will reduce the "average account age" and will therefore reduce your score. It's best to open one account and build upon that credit rather than opening several accounts and spending small amounts of money on each.
- 4. Amount of new credit.** (10%) Every time you apply for new credit (credit cards or loans), that inquiry is noted on your credit report. Lenders take note if there have been too many inquiries on your report in a short period of time.

When you do apply for new credit (such as a car loan), do so in short period of time. FICO can distinguish between multiple inquiries on a single loan (say, if you're shopping around for the best rates on that car loan) or multiple lines of credit.

- 5. Types of credit.** (10%) Credit cards and installment loans (like car loans or your mortgage) are examples of different types of credit. If you have had no credit, lenders will consider you a higher risk than someone who has managed their credit responsibly.



## Who Will Get the Loan?

Read through these scenarios, and use the information on the previous page to decide who is most likely to be approved for the loan. Who's least likely to get the loan?

- **Tim** pays his bills on time, but he has \$9,500 of debt on a credit card with a \$10,000 limit.
- **Mary** is working on paying off her credit card balance of \$2,500. She has paid off \$750 of that debt, and she is in otherwise good financial standing.
- **Nick** normally is very good about making timely payments on his debts. However, this month, he was unable to pay any of his bills.
- **Carrie** recently applied for an additional credit card. The credit limit is well within her means, and she has a solid credit history.



## The Low-Down on Loans

1. **Be realistic.** Borrow only what you need, and remember that you must pay back - with interest - whatever you borrow. Consider your earning potential after you graduate. Prepare a budget to see exactly how much you can afford to spend on monthly loan payments.
2. **Stay within what is an “acceptable” level of debt.** Your debt-to-income ratio is the measure of how much debt you carry to how much money (after taxes) you have coming in. Consider this example:

**Total credit card debt:** \$5,500

**Total after-tax annual income:** \$28,000

**Debt-to-income ratio:**  $5,500 / 28,000 = 19.6\%$

The ideal number is zero. But at the very least you want to keep your debt — including car loans — to 15% or less of your after-tax income.

3. **Read your application carefully.** Make sure you understand the terms of your loan. Once you sign the application, you're committing yourself to a real debt. You'll have to repay your student loan whether or not you finish school, and you'll have to pay off an auto loan even if you decide to sell the car.
4. **Make extra payments when you can.** Adding even a little extra money to your loan payment can pay big dividends in the long run. How? The more you pay off of your principal (your original loan amount), the less interest you pay.





## Credit Cards- The Other Loan

1. **A credit card is just that — a credit card.** Just because a credit card company has deemed you creditworthy, it does not mean that you should spend that money at will. Credit card companies are willing to let you borrow money for a short period of time- at a price. Interest rates can skyrocket at a moment's notice, and that can do nothing but shrink your pocketbook.
2. **Pay more than the minimum payment.** A credit card with an annual percentage rate of 18% is not your friend. In some cases, you may pay more interest than the sum of your minimum balance. Pay off as much of your balance as you can, especially on cards with high interest rates. Once you've paid off that card, destroy it or put it away- for good.
3. **Watch out for fees.** Of course, there are the more obvious fees — those incurred for late payments and overdrafts. However, you should also know that you could be charged a fee for ordering a replacement card, using a “convenience check,” or requesting an extra account statement. Other services that may require you to pay a fee: transferring a balance — either to or from your card, talking to somebody from customer service instead of using the credit card company's automated feature, or when you don't use your credit card for a certain period of time. Different credit card companies have different policies on service charges, so get the facts before signing up for the card.
4. **Ask if you can negotiate.** Do you want a lower interest rate? Don't want to pay an annual fee? Unwilling to pay the \$35 late payment fee? Some of these fees may be negotiable if your credit card company considers you to be a good customer. Many times, it's easier for your credit card company to remove the fee from your bill than to court a new customer. If you consistently pay your bills on time, you'll be in a much better position to get what you want.





## Types of Interest

It's never too early to learn about interest. In fact, the sooner you understand the different types of interest, the easier it will be for you to take control of your finances.

If you're looking to invest, interest is your number one friend. However, when you're borrowing money for a loan, interest can be your worst enemy.

What is compound interest? To understand compound interest, let's first define the two different types of interest: simple and compound.

**For example, let's say you invest \$1,000 in an investment vehicle.**

### Simple interest

Simple interest allows you to earn interest only on your original investment, or principal.

\$1,000 invested at a 10% interest rate compounded annually.

**Formula: Interest rate x principal = the interest to be added to your account**

**Year One:**  $10\% \times \$1,000 = \$100$

**Year Two:**  $10\% \times \$1,000 = \$100$

**Your Total Earnings:**

$\$1,000 + \$100$  (the interest earned in year one) +  $\$100$  (the interest you earned in year two) = **\$1,200**

### Compound interest

Compound interest occurs when interest is earned on your original investment plus on the interest already earned on that account. In other words, you earn interest on your interest.

**We will use the same formula we used in calculating simple interest.**

**Year One:**  $10\% \times \$1,000 = \$100$

**Year Two:**  $10\% \times \$1,100$  (the original principal plus the interest earned) =  $\$110$

**Your Total Earnings:**

$\$1,000 + \$100$  (the interest earned in year one) +  $\$110$  (the interest you earned in year two) = **\$1210**



# “Value of Money”

When it comes to saving or investing, it really does pay to start early. This chart illustrates how \$1,200 invested annually can grow over time, and how much less you'll have accumulated by age 65 if you wait 5 years, 10 years, 15 years or longer before starting to save or invest. This model assumes an annual return of 8%.

Begin at Age	Amount You'll Have Accumulated by Age							
	30	35	40	45	50	55	60	65
20	17,384	32,582	54,914	87,726	135,938	206,777	310,862	463,796
25	7,040	17,384	32,582	54,914	87,726	135,938	206,777	310,862
30	1,200	7,040	17,384	32,582	54,914	87,726	135,938	206,777
35		1,200	7,040	17,384	32,582	54,914	87,726	135,938
40			1,200	7,040	17,384	32,582	54,914	87,726
45				1,200	7,040	17,384	32,582	54,914
50					1,200	7,040	17,384	32,582
55						1,200	7,040	17,384
60							1,200	7,040
65								1,200



# Which Car Loan Is Best for You?

Okay, you've been pinching pennies for months, and you finally have \$2,800 saved up for a car. You find a great used car for \$10,800. Now all you need is a loan to cover the extra \$8,000 and you're set.

Take a look at each one of your loan options, and decide which loan is the best deal for you.

<b>Place</b>	<b>Principal</b>	<b># Payments</b>	<b>Interest Rate</b>	<b>Monthly Payment</b>
Dealer	\$8,000	36	23.5%	\$311.14
Bank	\$8,000	24	13.4%	\$381.84
Finance Company	\$8,000	48	33%	\$302.71



## Rule of 72 and the Credit Card Game

When you sign up for a credit card or apply for a loan, consider the amount of debt you'll be responsible for. Charge only what you think you can pay off within a year, and take out a loan that will allow you to pay it off in a timeframe you're comfortable with.

The "Rule of 72" allows you to determine the number of years before your debt doubles if you make no payments. To use the rule of 72, take 72 divided by the percentage rate you are paying on your debt.

For example:

You borrowed \$1,000 at 6% interest. 72 divided by 6 is 12. That means it would take you 12 years for your debt to double if you did not make payments.

Think of how quickly your debts can double with high interest rates. Review the following table. This table illustrates the value of paying more than your minimum balance each month. See what happens when you vary the minimum monthly payment on a credit card with a \$5,000 balance with 17% interest.

Card	Minimum % Payment	Monthly Payment	Total Interest Paid	Years to Pay Off Credit Card
A	1.67%	\$83.50	\$25,354	81
B	2.0%	\$100.00	\$11,304	40
C	2.5%	\$125.00	\$6,210	24
D	3.0%	\$150.00	\$4,296	18

