

Use the tips and strategies in this guide to do the following:

- » Weigh the benefits and risks of borrowing.
- » Compare the costs and terms of borrowing options.
- » Start the journey to establishing a good credit rating.
- » Explore the rights and responsibilities of borrowers and lenders.
- » Protect yourself from identity fraud.

MEET MARIAH AND JESSE

Mariah is upset. Her mom said “no way!” to helping her get a credit card. Mariah pointed out that she has a part-time job at the mall to pay the bills and that she’s a junior now and will be going off to college soon—but her mom wouldn’t even discuss it.

Jesse dreads the thought of having to drive the family clunker next year when he gets his license. He doesn’t have a job, but he’s been saving for a few years and has \$2,500 now, which he was hoping to use to spend on a truck—until he actually started checking out truck prices.

Jesse’s older brother said their parents might agree to cosign a loan for him if he gets a job before then. Jesse isn’t sure he wants the responsibility of a car payment every month, so he wants to figure out how much the payments would be before he proposes the cosigning idea.

Both Mariah and Jesse will join us as we talk about borrowing and debt.



THE SIREN SONG OF BORROWING



What Do YOU Think?

Are these good reasons to borrow money?

- » Taking out a \$5,000 student loan for college tuition
- » Charging dinner and movie tickets during a night out with your friends
- » Buying a laptop that's on sale using the store's financing program
- » Getting a loan to pay your credit card bills
- » Charging repairs to get your car running again
- » Borrowing cash from a friend to buy some magazines

“Compound interest is the eighth wonder of the world. He who understands it, earns it ... he who doesn't ... pays it.”

*~ Nobel Prize-winning physicist
Albert Einstein*

Credit cards, auto loans, home mortgages, pawn shops ... you've probably heard a lot about these forms of credit over the years—good and bad. But credit itself is actually neither. **Credit** is merely a tool to buy something now and pay for it later.

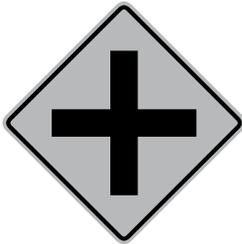


How we use credit is what's good or bad.





After all, none of your favorite products would exist if businesses hadn't borrowed money to make the products. For example, small, short-term loans known as **microloans** help hardworking people fund businesses in low-income communities as part of a plan to reduce poverty.



Borrowing also can be a lifesaver in an emergency—you can't just tell a rupturing appendix to wait until payday. By accepting a credit card payment, the hospital essentially lets you take a loan from the credit card issuer to pay for the emergency appendix surgery.

On the other hand, too many people eagerly "buy now" without thinking about their ability to "pay later." So, they end up owing money for purchases they might not even remember making or really didn't need in the first place. They also pay more than what each item cost.

Even if you don't need to borrow money today, you'll soon be flooded with tempting offers for car loans, credit cards, cash-advance loans, cellphone service, and more. Boosting your borrowing IQ now will prepare you to make smarter decisions whenever you decide to take the credit plunge.



Activity 2.1: Borrowing Fitness Test

Do you have what it takes to be a responsible borrower? Find out by answering the questions below.

Do you ...

- _____ **1** Repay money loans from friends and family before they have to ask you for it?
- _____ **2** Often borrow money to pay for something you can't afford right now?
- _____ **3** Return library books and other borrowed items before they're due and return them in good condition?
- _____ **4** Frequently ask for an advance on your paycheck or allowance?
- _____ **5** Replace money you borrow from your savings account or from other spending-plan funds?
- _____ **6** Borrow items from your parents or siblings without asking for or getting permission first?
- _____ **7** Know how much money you owe others right at this very moment?
- _____ **8** Ever make monthly or weekly payments late?

The more "yes" answers you have on the odd-numbered questions and "no" answers on the even-numbered questions, the more fit you are to be a smart borrower! If you didn't do well, don't worry. It's never too late for a bad-habit makeover.

REAP THE REWARDS

There are many reasons why people borrow money instead of paying cash, such as:

- » **Convenience.** Using a credit card can be more practical when shopping online. When shopping in person, it's safer and easier than carrying around a large wad of cash.
- » **Instant gratification.** You didn't budget for the purchase and don't want to wait until you have the money to buy the item.
- » **Protection.** It's easier to get refunds on credit card purchases. Some cards also insure purchases in case an item is damaged, lost, or stolen shortly after buying.
- » **Emergencies.** When you don't have enough money in your emergency fund, borrowing can be a temporary fix for unexpected expenses like patching a leaking roof.
- » **Spreading out payments for expensive items.** Most people would never be able to buy a house, car, or college education if they had to save all the money for it first.
- » **Investments.** Borrowing money to invest in a business or property can be an opportunity to use a little money to make more money.
- » **Credit history.** Just like you need diplomas and job references, you need good credit references. Building a good credit history can help you qualify for deals on loans, credit cards, insurance, and more.
- » **Special offers and perks.** Some people like to earn discounts or loyalty rewards that credit issuers occasionally offer.



While these reasons may be popular, they're not always smart. We'll talk more about that shortly. First, let's take a big-picture look at borrowing.



Activity 2.2: What is the Reason?

1 What do you think is Mariah's reason for getting a credit card?

2 What do you think is Jesse's reason for using a loan to buy a truck?

3 Finally, which of the Reap the Rewards reasons have prompted you to borrow money from friends or family?

CREDIT MAKES THE WORLD GO 'ROUND

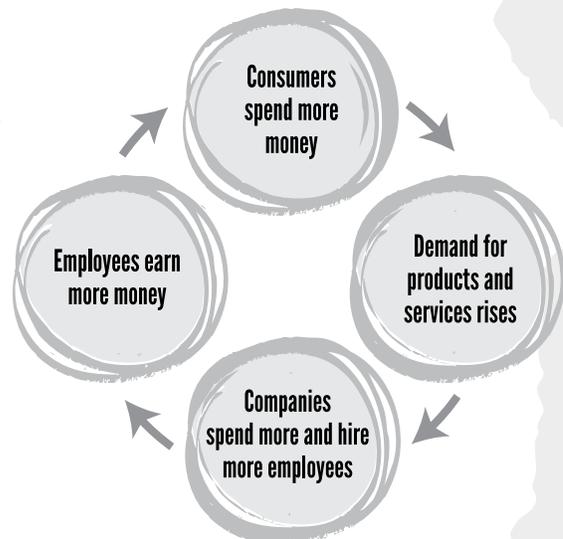
Who's in the driver's seat of the U.S. economy? You!

Consumer spending fuels a whopping 70 percent of our nation's economic growth.¹ When consumers spend more money, demand for products and services increases.

To meet the new demand, companies buy more equipment, hire more workers, and give more pay raises. That means, these employees now have more money to spend ... and the cycle of economic growth continues.

Borrowing is one way consumers can spend more when their income isn't increasing. That can help the economy grow.

But, as we've seen in recent years, too many consumers borrowing more than they can afford ultimately can end up hurting the economy.



¹ *Flow of Funds Accounts in the United States*, Federal Reserve, Dec. 8, 2011

DIAL 'B' FOR BORROW

There are many options for borrowing money. But they all boil down to four main types of accounts:

Revolving credit lets you borrow up to a maximum dollar amount whenever you want, without applying for credit each time. And there's no set payoff date.

"When a man is in love or in debt, someone else has the advantage."

~ Radio host Bill Ballance

In the case of a credit card, you can choose to repay the full amount each month and owe no interest. But if you make only the minimum payment, the interest charges will really add up. Credit card interest rates are typically costly. Keep track of what you buy so you don't charge more than you will repay each month.

Installment credit is also known as **closed-ended credit** because the entire loan amount is paid to you at once. Then, you repay the loan, with interest, in a set number of equal payments by a specific payoff date.

Installment loans are often used for big-ticket items such as a car or home. If you want to borrow more money or change the loan terms, you must take out a new loan.

Cash loans (aka personal loans) often have no specific purpose and simply pay the borrowed funds directly to you. You may have to repay the amount borrowed plus interest all at once, although some lenders allow you to make payments over time for large amounts.

Avoid paying high interest and fees by comparing interest rates when borrowing cash. Getting a cash advance from your credit card or a payday loan is typically more expensive than borrowing cash from a bank or credit union.

Service credit lets you pay in full, usually monthly, for a service as charges add up. You use service credit when you contract for phone service or electrical service. However, the service provider can deny your application for service based on your credit history or require a deposit before approving you.

As with revolving credit, you will not pay interest or late fees if your payment for services reaches the lender by the due date.

BEWARE OF COMPOUND INTEREST

When a revolving credit balance or service credit balance is not paid by the due date, interest is charged on the unpaid amount. Left unpaid, interest **compounds** each time it is calculated on the original principal plus any interest that accumulated from previous periods.



Study the example below to figure out how much is owed if a credit card balance isn't paid until the end of Month 4.

Month	Principal	20% APR	Balance
1	\$1,000.00	$(\$1,000 \times .2 \times 1/12) = \16.67	\$1,016.67
2	\$1,016.67	\$16.94	\$1,033.61
3	\$1,033.61	\$17.23	\$1,050.84
4			

STEALING FROM YOUR FUTURE SELF



Remember that every time you take out a loan or make credit card purchases for more than you will repay in full that month, you're actually borrowing from two people: the lender and your future self. Smart borrowers know that **every dollar borrowed today is a dollar less to spend from the next paycheck.**