Lesson 9

Take Control of Debt – The Cost of Credit

Lesson Overview

Description

Students begin this lesson exploring the connection between credit and debt. After examining types of credit, peer-to-peer lending and high-cost credit, students analyze credit scenarios and determine which they would choose and why. The lesson concludes with understanding the language of loans such as annual percentage rate, finance charge, principal and prepayment penalty.

Standards

- National Standard in K-12 Personal Finance Education
- Texas State Social Studies Standards
- Texas State CTE Standards

Instructional Objectives

- Identify the types of credit available to a consumer.
- Compare and contrast the different sources of credit.
- Examine the cost of borrowing.
- Analyze the impact of purchases financed with credit.

Time Required

- One 45-minute class period.

Materials Required

- PDF slides
- Copies of Handout 1: Guided Notes
- Copies of Handout 2: Cost of Credit
- Copies of Assessment 1: High-Cost Credit Essay
- Copies of Assessment 2: Quiz

Lesson Procedures

1. **Display slide 1.** Tell students the topic of this lesson is the cost of credit and understanding loan terms.

2. **Display slide 2.** Review the instructional objectives for the lesson.

3. **Display slides 3-5.** Explain the connection between credit and debt.

   Credit:

   - The granting of money or something else of value in exchange for a promise of future repayment.

   Tell students that when a person cannot pay cash for a car, house or college, they can finance the purchase using credit.

   Debt:

   - Represents money owed.

   Remind students that the net worth is the value of the assets minus the money you owe. Driving an expensive car doesn't make you automatically wealthy. It depends on how much money you owe.

   Tell students that taking on debt decreases your wealth and net worth since debt is considered a liability.

4. **Display slide 6.** Give students time to observe the graph on the slide and answer the following questions in their guided notes.

   - What is the first thing that stands out to you?
   - What else did you observe?
   - What new questions do you have?

   After students are finished writing their questions in their guided notes, ask them to share with the class.

   Tell students that this graph represents the total U.S. household debt, which was $15.6 trillion in fourth quarter 2021.

   Mortgage balances—the largest component of household debt—rose by $258 billion and totaled $10.9 trillion at the end of December 2021.

5. **Display slides 7–11.** Review the types of credit and characteristics of revolving and installment credit.

   - Explain to students that household debt is accumulated when people use credit.
   - Review the types of credit.

- **Revolving credit** is when people can access a capped limit of funds that may be used repeatedly after partial or total repayments have been made:
  - Home equity line of credit.
  - Credit card.
- **Installment credit** is when people borrow funds with a fixed payment and schedule for a specified time:
  - Car loan.
  - Student loan.
  - Home loan.
- **Service credit** includes types of credit with service providers and requires full payment for each period:
  - Cellphone service bill.
  - Gym membership bill.
  - TV subscription bill.

Suggested questions for student discussion:

- Ask students if they currently use any source of credit. Answers will vary but might include: gym membership, streaming service subscription, gaming subscription. If students share that they have a car loan, remind them that a loan is a legally binding contract, and you need to be at least 18 years old to sign a contract. Other options can include having a co-signer over the age of 18 such as a parent.

Classroom response strategy:

- Have students fill in the blanks on their guided notes for revolving, installment and service credit.

6. **Display slides 12-13.** Tell students that there are additional sources of credit such as peer-to-peer lending and high-cost credit.

- **Peer-to-peer lending** involves lending money through online services by matching borrowers with investors. The borrower never deals directly with the investor; rather a peer-to-peer provider handles all the transactions. Features of peer-to-peer lending include:
  - Online platform.
  - Fast application process.
  - Alternative source of credit.
- Peer-to-peer lending often attracts borrowers who are credit constrained and lack collateral and the capacity to take on more debt.
  SOURCE: balyuk-paper.pdf (fdic.gov)

- Tell students that interest rates for peer-to-peer lending compare favorably to credit card rates with a median rate of 17.1 percent. However, a significant portion of peer-to-peer borrowers pay rates well above 20 percent.
  SOURCE: [balyuk-paper.pdf (fdic.gov)]

Classroom response strategy:

- Have students fill in the blanks on their guided notes.

7. **Display slides 14–15.** Review high-cost credit.

   Payday loan:

   - A type of short-term loan taken out against the borrower's paycheck. In exchange for money, the borrower writes a post-dated check.
     - Small-dollar loan.
     - Typically, due by the next payday.
     - High interest rate and fee(s).

   Auto title loan:

   - A type of short-term loan that requires your car as collateral to borrow money. If you don't pay the loan back, the lender can repossess (take) your car.
     - High interest rate and fee(s).
     - Small-dollar loan.
     - Requires using auto title as collateral for the loan.
     - Must be 18 years old to take out the loan.

8. **Display slide 16.** Tell students that it is up to each state to determine interest rate and fee rules and whether payday and auto title lenders can operate within each state.

   Suggested questions for student discussion:

   - Why would someone want to use a high-cost credit option like a payday loan or auto title loan? Answers will vary but might include: no or low credit score, unbanked, emergency situation or to meet basic needs.
   - How does the interest rate compare to traditional loans? Answers will vary but might include: interest rates are higher than traditional loans.

   Classroom extension activities:

   - To extend students' understanding of payday loans, print copies or direct students to the PDF available online, [Fast Cash and Payday Loans] (Page One Economics, Focus on Finance). This short overview of payday lending covers payment plan options, how to calculate the cost of

payday loans, and state and federal regulation. Have students read the short essay and answer questions provided.
- Play the following six-and-a-half-minute video, Understanding Payday Loans, from the National Credit Union Association.

9. **Display slide 17.** Distribute Handout 2: The Cost of Credit.
    - Group students into pairs or small groups.
    - Give students time to read through each scenario and determine which they would choose and why in their handout.
10. **Display slides 18–28.** After students complete their handout, review the scenarios and the cost of each option with students.

    Student loan:

    - Tell students that calculations for payments and interest paid assumes the federal loans were subsidized and interest didn't accrue during college enrollment.
    - Payments and interest would be higher if the loan examples included a combination of subsidized and unsubsidized loans.
    - For additional details on federal loan amounts and how much a student can borrow, visit Subsidized and Unsubsidized Loans | Federal Student Aid.
    - To view current federal student loans interest rates, visit Federal Interest Rates and Fees | Federal Student Aid.
    - Tell students the difference between slide 20 and slide 21 is the length of the loan term.
    - Ask students what happened to the payment from a 10-year to a 20-year loan term.
      SOURCE: Payment Calculator for Mortgages, Car Loans and Other Term Loans – Dallasfed.org

    Medical bill:

    - Tell students that medical providers often offer payment plans to patients who are unable to pay for services in full.
    - Leaving medical bills unpaid for too long could impact their credit.
      SOURCE: Credit Card Calculator.

    Car loan:

    - Tell students that interest rates are typically lower for shorter-term loans. In addition, interest rates are also typically lower for new versus used cars.
    - Sales tax and fees can vary from state to state. Example fees can include: license, registration, title, inspection fees and/or inventory tax.
    - Have students use the information on the slide and the formula to calculate the total cost of each car.

- Answers:
  - The total cost of purchasing the $14,000 car is $17,000.08.
  - The total cost of purchasing the $20,000 car is $26,343.66.

  SOURCE: Auto Loan Calculator.

Suggested questions for student discussion:

- What are the advantages and disadvantages of your choice?
- Which option has the highest cost?
- What are the consequences of borrowing more than you need?
- After reviewing each scenario and the costs, ask students if they would change their choice and if so, why?

11. **Display slide 29.** Have students brainstorm answers to the question "What additional costs should you consider before purchasing a car?" Answers will vary but might include: yearly registration fees, toll charges, gas, oil changes and tires.

Classroom response strategy:

- Have students record their answers in their guided notes before sharing.

12. **Display slides 30–32.** Tell students that it is important to choose loans carefully, which includes understanding the following terms:

Loan:

- A sum of money lent with interest. It is a liability or debt and decreases your wealth.

Principal:

- The unpaid balance on a loan. Tell students that the principal on a loan decreases over the term of the loan.

Interest:

- A fee for the use of money over time.

Interest rate:

- The percentage charged for a loan. Interest rates can be fixed or variable.
  - Fixed rate means the interest rate on your loan does not change over the term of the loan.
  - Variable rate means the interest rate on your loan can change.

Annual percentage rate (APR):

- The annual rate that is charged for borrowing.
  - The APR represents the actual yearly cost of funds over the term of a loan.
  - The APR includes any fees or additional costs associated with the loan.

Finance charge:

- A fee charged for the use of credit. It may be a flat fee or a percentage of borrowings. It can include: transaction fees, account maintenance fees or late fees.

Prepayment penalty:

- A fee charged for paying back the loan before the end of its term.
- Lenders are not allowed to charge you a prepayment penalty if you pay your student loans off early.

Suggested question for student discussion:

- Why would a lender charge a repayment penalty? Answers will vary but might include: lenders make money from the interest they charge on loans. When you pay off the loan early, the lender doesn't earn as much interest.

13. **Display slides 33–35.** Review taking on debt tips.
14. **Display slide 36.** Review learning objectives with students.
15. **Distribute Assessment 1:** High-Cost Credit Essay.
    - Play the eight-minute video, The Surprising Logic Behind the Use of Check Cashers and Payday Loans, for students in class. Then review the instructions with students.
    - Give students time to research their topic and complete their essay.
16. **Distribute Assessment 2:** Quiz.
17. **Additional Resource:**
    - The Federal Reserve Bank of New York: Household Debt and Credit Report.

Name____ Date____________

Lesson 9—Handout 1

Guided Notes

Vocabulary

Credit—The granting of money or something else of value in exchange for a promise of future repayment.

Debt—A liability and represents money owed.

Revolving credit—Access to a capped limit of funds that may be used repeatedly after partial or total repayments have been made.

Installment credit—Borrowing of funds with a fixed payment and schedule for a specified time.

Service credit—A type of credit with service providers and requires full payment for each period.

Peer-to-peer lending—Lending money through online services by matching borrowers with investors.

Payday loan—A type of short-term loan taken out against the borrower's paycheck. In exchange for money, the borrower writes a post-dated check.

Auto title loan—A type of short-term loan that requires your car as collateral to borrow money. If you don't pay the loan back, the lender can repossess (take) your car.

Loan—A sum of money lent with interest.

Principal—The unpaid balance on a loan.

Interest—A fee for the use of money over time.

Interest rate—The percentage charged for a loan.

Annual percentage rate (APR)—Annual rate that is charged for borrowing. The APR includes any fees or additional costs associated with the loan.

Finance charge—A fee charged for the use of credit. It may be a flat fee or a percentage of borrowings. It can include: transaction fees, account maintenance fees or late fees.

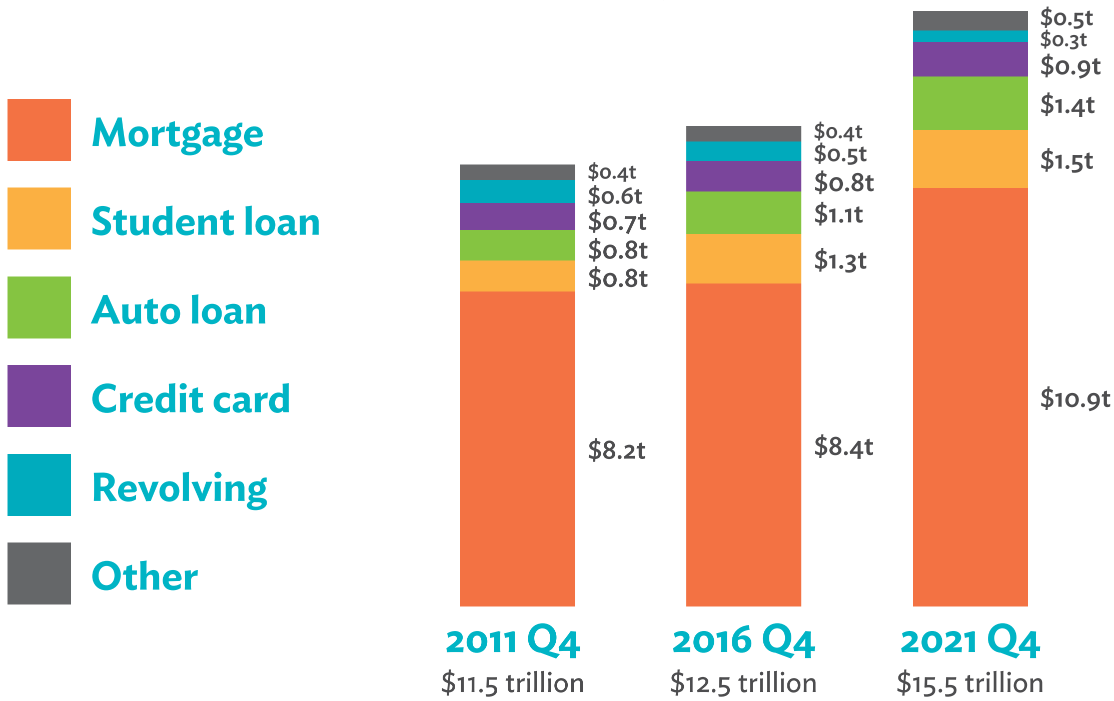
Prepayment penalty—A fee charged for paying back the loan before the end of its term.

Name______________________________ Date______________

Lesson 9—Handout 1

Guided Notes (Cont.)

Household debt and its composition:



What is the first thing that stands out to you?

What else did you observe?

What new questions do you have?

Name____ Date________________

Lesson 9—Handout 1

Guided Notes (Cont.)

Fill in the blank:

Revolving credit is when people can access a capped limit of funds that may be used repeatedly after partial or total repayments have been made.

- ________________________________
- ________________________________

Installment credit is when people borrow funds with a fixed payment and schedule for a specified time.

- ________________________________
- ________________________________
- ________________________________

Service credit includes types of credit with service providers and requires full payment for each period.

- ________________________________
- ________________________________
- ________________________________

Peer-to-peer lending involves lending money through online services by matching borrowers with investors. The borrower never deals directly with the investor; rather a peer-to-peer provider handles all the transactions. Features of peer-to-peer lending include:

- ________________________________
- ________________________________
- ________________________________

What additional costs should you consider before purchasing a car?

Name____________________ Date____________

Lesson 9—Handout 2

Cost of Credit

Shiloh, 19, High School Senior

Shiloh just graduated high school and has been accepted to a state university 300 miles from home. The cost of tuition, room and board are covered by grants and scholarships, but the meal plan, which is $3,000 per year, books and additional living expenses are not covered.

The financial aid offer Shiloh received gives the option of taking a federal student loan up to $9,500 per year to help cover the additional costs.

$3,000 per year

$5,000 per year

$9,500 per year

Which would you choose? List the advantages and disadvantages of your choice.

Name________________________________ Date______________

Lesson 9—Handout 2

Cost of Credit (Cont.)

Reece, 19, Guest Services Clerk

Reece is currently working part time as a guest services clerk at a local hotel. As a part-time employee, Reece doesn't qualify for health insurance. After an accident in the kitchen at home, Reece received stitches at a local urgent care. The final bill was $800, and Reece couldn't afford to pay the bill with cash nor has any family or friends to borrow money from. The three options Reece is considering are below.

Option 1. Pay the bill on a credit card and make fixed monthly payments for a year.

Option 2: Pay the bill on a credit card and make minimum monthly payments until the debt is paid off.

Option 3: Apply for a payment plan (loan) with the urgent care and make fixed monthly payments for 2 years.

Which would you choose? List the advantages and disadvantages of your choice.

Name____ Date____________________

Lesson 9—Handout 2

Cost of Credit (Cont.)

Avery, 22, Social Media Strategist

Avery recently moved to Houston, Texas, for a new job and is currently using a ride-sharing app to commute to work. The cost of using the ride-sharing app is about $600 per month. Avery is considering purchasing a car and has budgeted $500 per month for the payment and insurance. Below are the estimated costs of each choice.

	4-year loan	6-year loan
Auto price:	**$14,000**	**$20,000**
Loan term:	**48 months**	**72 months**
Interest rate:	**5.3%**	**6.7%**
Down payment:	**$2,000**	**$2,000**
Monthly payment:	**$312.50**	**$338.11**

Which would you choose? List the advantages and disadvantages of your choice.

Name______________________________ Date______________

Lesson 9—Assessment 1

High-Cost Credit

Instructions:

- After watching the PBS Newshour video, "The Surprising Logic Behind the Use of Check Cashers and Payday Loans," choose a position to support or not support the use high-cost credit services such as check cashing, payday loans and other high-cost credit services.
- Find at least three additional sources to support your position.
- Write a five-paragraph argumentative essay on your position using the research you found.

Choose your position: ______________________________

After your research is complete, use the space below to draft your essay.

Introduction

Body (include supporting evidence from your research)

Name____ Date______________

Lesson 9—Assessment 1

High-Cost Credit (Cont.)

Body (include supporting evidence from your research)

Body (include supporting evidence from your research)

Conclusion

Name____ Date__________________

Lesson 9—Assessment 2

Quiz

Directions: Match the following terms to the correct definition:

1. _____ **Finance charge**	A. Unpaid balance on a loan
2. _____ **Revolving credit**	B. The percentage charged for a loan
3. _____ **Peer-to-peer lending**	C. Borrowing of funds with a fixed payment and schedule for a specified time
4. _____ **Principal**	D. Lending money though online services by matching borrowers with investors
5. _____ **Installment credit**	E. A fee charged for the use of credit
6. _____ **Interest rate**	F. Access to a capped limit of funds that may be used repeatedly after partial or total repayments have been made

Select the correct answer below.

7. ◯ Increase/ ◯ Decrease What happens to the total finance charge as a loan term lengthens?
8. ◯ Increase/ ◯ Decrease What happens to the monthly payment as a loan term lengthens?
9. ◯ Increase/ ◯ Decrease What is the effect of a higher APR on a monthly payment?

Write a short response to the following question:

10. What is the difference between an auto title loan and a payday loan?

Name____________________ Date____________________

Lesson 9—Handout 1

Guided Notes Answer Key

Fill in the blank:

Revolving credit is when people can access a capped limit of funds that may be used repeatedly after partial or total repayments have been made.

- **Home equity line of credit.**
- **Credit card.**

Installment credit is when people borrow funds with a fixed payment and schedule for a specified time.

- **Car loan.**
- **Student loan.**
- **Home loan.**

Service credit includes types of credit with service providers and requires full payment for each period.

- **Cellphone service bill.**
- **Gym membership bill.**
- **TV subscription bill.**

Peer-to-peer lending involves lending money through online services by matching borrowers with investors. The borrower never deals directly with the investor; rather a peer-to-peer provider handles all the transactions. Features of peer-to-peer lending include:

- **Online platform.**
- **Fast application process.**
- **Alternative source of credit.**

Name____ Date____________________

Lesson 9—Assessment 2

Quiz Answer Key

Directions: Match the following terms to the correct definition:

1. __E__ **Finance charge**	A. Unpaid balance on a loan
2. __C__ **Revolving credit**	B. The percentage charged for a loan
3. __D__ **Peer-to-peer lending**	C. Borrowing of funds with a fixed payment and schedule for a specified time.
4. __A__ **Principal**	D. Lending money though online services by matching borrowers with investors.
5. __F__ **Installment credit**	E. A fee charged for the use of credit.
6. __B__ **Interest rate**	F. Access to a capped limit of funds which may be used repeatedly after partial or total repayments have been made.

Select the correct answer below.

7. **Increase**/Decrease — What happens to the total finance charge as a loan term lengthens?

8. Increase/**Decrease** — What happens to the monthly payment as a loan term lengthens?

9. **Increase**/Decrease — What is the effect of a higher APR on a monthly payment?

Write a short response to the following question:

10. Explain the difference between an auto title loan and a payday loan?

An auto title loans requires a car as collateral to borrow money, and a payday loan is a loan taken out against a future paycheck.