Lesson 6.3: Making Credit Choices

Lesson Author

Amy Krzyzanowski, University of Delaware's Center for Economic Education & Entrepreneurship

Standards and Benchmarks

See page 4.

Lesson Description

Using credit can help people pay for purchases sooner, but borrowing also comes with costs and responsibilities. Making smart credit decisions requires thinking carefully about the purpose of the purchase, how soon it is needed, the total cost of borrowing, and whether repayment is realistic. In this lesson, students explore the factors that should be considered before using credit and practice evaluating borrowing decisions in a variety of real-life situations. Students begin with a quick decision-making activity where they decide whether to borrow, save, or adjust, then work together to create a class checklist for making credit decisions. They apply that checklist to more complex credit scenarios and conclude by reflecting on the tradeoffs and consequences that come with using credit. To obtain answer keys for the handouts and assessment in this lesson, create an account on FederalReserveEducation.org.

Concepts

Auto loan
Buy now, pay later
Credit
Credit card
Mortgage
Personal Loan
Student Loan

Objectives

Students will be able to:

- develop and apply criteria for determining when the use of credit is appropriate.
- justify the use of credit for a specific purpose.

Compelling Question

How do you know when to use credit?

Time Required

45 minutes

Materials

- Making Credit Choices Lesson 6.3 Slides
- Handout 6.3.1: Credit Scenarios, one copy for each student
- Handout 6.3.2: Assessment, one copy for each student

Preparation

- You will need to print and cut apart Handout 6.3.1: Credit Scenarios.

Procedure

1. Display Slide 2 and briefly review the common types of **credit** including **credit cards**, **auto loans**, **mortgages**, **student loans**, **personal loans**, and **buy now, pay later**. Remind students that each type of credit is designed for different purposes and situations. Then ask: How do you know when using credit is the right choice? (*Answers will vary.*)

    a. Tell students that in this lesson they will examine the factors to consider when making credit decisions so they can use credit responsibly.

2. Display Slide 3. Tell students that they will participate in a quick decision-making activity. Explain that for each scenario, they should assume they do not currently have enough money saved to make the purchase. Their choices are to borrow (use some form of credit to pay now), save (wait to save more and buy later), or adjust (change the plan by choosing a different option).

3. Assign each option a number: 1 for borrow, 2 for save, and 3 for adjust. Instruct students to hold up the number that matches their choice after each scenario is read. Remind students to think about what is shaping their choices and be ready to reflect on this after the activity.

4. Using Slides 4-8, read each scenario aloud and have students quickly decide which option they would choose. After each scenario, invite a few students to briefly explain their thinking. *(Answers will vary for each scenario).*

5. After all scenarios have been discussed, display Slide 9 and ask students to reflect on their decision-making process. Invite them to share what factors influenced their choices to borrow, save, or adjust. Record their ideas on the board or a large piece of chart paper at the front of the room. (*Answers will vary, but if needed, guide students to consider things like how important the purchase is, how soon it is needed, whether they can realistically pay it back, what borrowing will cost, and whether there are other options besides using credit.*)

    NOTE: It may be helpful to refer back to Slides 4-8 as students share their ideas

6. Explain to students that they will use the list of factors they just compiled as a class to evaluate more complex borrowing decisions. Before moving on, invite students to review the list and suggest any final additions or changes.

7. Place students into small groups of two or three and provide each group with one scenario from Handout 6.3.1: Credit Scenarios along with a piece of poster paper and a marker. Instruct students to use the class list to evaluate their assigned scenario and decide whether the person should borrow, save, or adjust. Responses to the prompts on Slide 10 should be recorded on poster paper.

    a. Should this person borrow, save, or adjust? Justify your recommendation.

    b. Identify the factor(s) that most influenced your decision.

    NOTE: If you have a class larger than 24 students, scenarios from Handout 6.3.1 can be used more than once.

8. After the posters are completed, invite each group to present their scenario and recommendations to the class. After each share-out, ask the class whether they agree or disagree and invite discussion about alternative recommendations.

Closure

9. Display Slide 11 and ask students the closure questions.

    a. What makes credit a smart choice in some situations but not in others? (*Answers will vary, but students may explain that credit can be a smart choice when the purchase is important, time-sensitive, or supports a long-term goal and repayment is realistic. It may be less wise when the purchase can wait, lower-cost options exist, or repayment would be difficult*.)

    b. How can taking time to think through your options lead to better borrowing decisions? (*Answers will vary, but students may explain that taking time to think through options can help them compare alternatives, understand the full cost of borrowing, make sure repayment is realistic, and avoid making rushed decisions they may regret later.*)

    c. What tradeoffs do people make when they choose to use credit? (*Answers will vary, but students may explain that using credit allows someone to get something sooner, but it also means repaying the money later, possibly with interest or fees, having less money available for future goals, or taking on financial risk if their circumstances change*.)

Assessment

10. Provide each student with a copy of Handout 6.3.2: Assessment. Instruct students to complete this assignment based on something they would like to buy or pay for in the next year. See the answer key and assessment rubric for detailed grading guidance.

Standards and Benchmarks

National Standards for Personal Financial Education

Standard 5: Managing Credit

Credit allows people to purchase and enjoy goods and services today, while agreeing to pay for them in the future, usually with interest. There are many choices for borrowing money, and lenders charge higher interest and fees for riskier loans or riskier borrowers. Lenders evaluate creditworthiness of a borrower based on the type of credit, past credit history, and expected ability to repay the loan in the future. Credit reports compile information on a person's credit history, and lenders use credit scores to assess a potential borrower's creditworthiness. A low credit score can result in a lender denying credit to someone they perceive as having a low level of creditworthiness. Common types of credit include credit cards, auto loans, home mortgage loans, and student loans. The cost of postsecondary education can be financed through a combination of grants, scholarships, work-study, savings, and federal or private student loans.

Benchmarks Grade 8

3. The longer a loan repayment period and the higher the interest rate, the larger the total amount of interest paid by a borrower.
4. Credit cards typically charge higher interest rates on balances due compared with rates on other types of loans.
6. When people borrow money to invest in higher education or housing, the risks and costs may be outweighed by the future benefits.
7. Borrowing increases debt and can negatively affect a person's finances.

Handout 6.3.1: Credit Scenarios (Page 1 of 2)

Scenario 1: Kaya graduated from high school last year and works part-time at a local grocery store. She has been accepted into a nursing program and is excited about the opportunity because nurses in her area earn strong salaries and are in high demand. Kaya has some savings and earned a small scholarship, but it will not cover all of her tuition and books. Kaya has been researching student loans and knows she would have to repay the money after graduation. Should Kaya take out a student loan?

Scenario 2: Ethan is a high school senior who uses his laptop every day for school assignments and college applications. Last week, his laptop stopped working, and the repair shop told him it would cost almost as much to fix it as to replace it. Ethan found a new laptop on sale for $750, but he only has $200 saved. He has a credit card and knows he could buy it now and pay it off over time. Should Ethan use his credit card to buy the laptop?

Scenario 3: Jasmine works part-time and attends community college. She drives 20 minutes to work and school each day in an older car that has needed several repairs this year. Last week, her mechanic told her the next major repair may cost more than the car is worth. Jasmine found a reliable used car at a dealership, but she would need to take out a loan and make monthly payments. Should Jasmine buy the used car?

Scenario 4: Tyler recently moved into his first apartment. A few days ago, his refrigerator stopped working, and replacing it will cost $850. Tyler has some money saved, but not enough to cover the full cost. The appliance store offers a Buy Now, Pay Later plan that would allow him to make four smaller payments instead of paying all at once. Tyler likes the idea of spreading out the payments, but he knows it is still a form of borrowing. Should Tyler use the Buy Now, Pay Later option?

Handout 6.3.1: Credit Scenarios (Page 2 of 2)

Scenario 5: Marcus and Ava have been married for two years and are currently renting a small apartment. They would like to buy a home before starting a family and have found a modest house in a neighborhood they like. The monthly mortgage payment would fit within their budget, but it would be at the very top of what they could comfortably afford. Buying the home would give them more space and stability, but it would leave little room in their budget for unexpected expenses or other financial goals. Should Marcus and Ava buy the house now?

Scenario 6: Minh has been accepted to her dream college in another state. She has always wanted to attend this school, and many of her close friends will be going there too. The college has the program she wants, but even after scholarships and family contributions, Minh would need to take out large student loans that could take many years to repay. She has also been accepted to a less expensive college closer to home, but it is not her first choice. Should Minh take out the larger student loans to attend her dream school?

Scenario 7: Ravi is a college freshman and has been invited to go on a weekend trip with friends to a music festival. The trip will cost about $600 for tickets, food, hotel, and gas. Ravi has enough money saved to cover part of the trip, but not the full amount. He could use his credit card to pay for the rest and make the payments over the next few months. Ravi knows this is not an emergency, but he does not want to miss out on the experience. Should Ravi use his credit card to pay for the trip?

Scenario 8: Kim has been working part-time while attending community college and recently moved into a new apartment. A water pipe burst in the apartment above hers, damaging her furniture and laptop. Her renter's insurance will cover part of the cost, but it may take several weeks before she receives the money. Kim needs to replace some of the damaged items right away so she can keep up with school and work. Her bank has offered her a small personal loan with fixed monthly payments. Should Kim take out the personal loan?

Handout 6.3.2: Assessment

Instructions: Think of something you would like to buy or pay for in the next year. It could be a car, college tuition, technology, travel, or another personal goal.

Answers will vary, but a sample response could be:

1. What is the purchase?

2. Would you choose to borrow, save, or adjust? If choosing to borrow, which type of credit makes the most sense?

3. Which factors from the class checklist matter most in your decision? Explain.

4. What tradeoffs would come with your choice?