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CHAPTER 7

Loans and Credit

When should I borrow money?

When you want to buy something and don't have the money to pay for it right away, should you borrow the money? When you borrow money from another person, like a parent, or a formal lender, like a bank, it is important to think about your ability to repay the money. How much time will you need to repay it? Can you meet your goal in the time you have? What fees will you have to pay to borrow someone else's money? Let's learn a little more.

WHAT IS A LOAN?

A loan is money that you borrow from a lender for a specific purpose with a promise to pay it back at a later time, with an agreed payment schedule. Getting a loan allows you to enjoy something now while giving you the flexibility to pay for it later. The amount of money you borrow is called principal. The fee for borrowing the money is called interest. The time you take to pay the money back is called the term.

Sometimes borrowed money, loan, and credit mean the same thing, but they can be different. Credit, for example, can refer to your ability to get a loan depending on how you paid back other loans. It is very important you pay your loans back on time. This will help you build a "good credit" record and may help you borrow money again when you need it.

Let's look at an example:

Remember Isabella, the fourth grader who loves to play basketball? Her local basketball team is hosting a camp for point guard players and has invited the star point guard from the local university to give pointers. The camp is one week away and the cost of the camp is $100. She wants to go to the basketball camp next week, but she does not have enough money to pay for it herself. Isabella asks her parents if she can borrow it from them and pay it back later.

Isabella sat down with her parents and reviewed her income and expenses. Isabella has savings of $75 and an income of $20 a month with no expenses. Isabella and her parents agreed that she had to pay some of the fee herself from her savings. If she uses $25 of her savings toward the $100, she will need to borrow $75 to pay for camp. This will leave her with $50 still in her savings. Isabella's parents agreed to loan her the rest of the money.

Her parents wanted her to understand the cost of borrowing money so they set up a plan with Isabella to repay the loan of $75 plus 1 percent interest (75 x .01), a $.75 fee. The total Isabella will pay back is $75.75 over a five-month term. Her monthly payments can be figured by dividing the total of $75.75 by five months. To pay her parents back the loan with interest in the term of five months, Isabella owes her parents $15.15 each month. She will build good credit with her parents if she stays on track.

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WHAT ARE SOME THINGS TO CONSIDER WHEN THINKING ABOUT A LOAN?

When you borrow money from any lender, think about your income, expenses, and your ability to repay the loan. Think about the time it will take to pay the loan back and what you might have to give up in order to pay it back. Start small and be sure to repay your loan on time. By making your loan payments on time, you build trust with the lender, which builds good credit and increases the chances that the lender will consider any future loan requests.

Remember borrowed money is not your money. Both the principal and the interest will have to be paid back on time, so be careful about the things you buy with a loan. Isabella worked hard and paid back her parents on time. Through her efforts, she built good credit and made it possible for her parents to consider loaning her money again.

Student Questions

What is a loan?

What is principal?

What is term of the loan?

What is interest?

What are some things you would like to buy if you could borrow money? How would you pay it back?

What are ways you can build good credit?