THE COST OF BORROWING

Name: Class/Block: Date:

So you found a good deal and made a purchase. Should you pay cash or use a credit card? When you use your credit card, the cost depends on when you'll pay it off, and what the interest rate is. *Unless you pay before the due date, credit adds cost.*

Use the example below to calculate how much it costs to use credit:

Martin is starting university and wants a laptop computer. He finds one for $200 off the regular price – with taxes, it's $1,498, just below his credit card limit. He has the money in a savings account, but he decides to put the computer on his credit card so he can use his savings for other purchases. When the statement arrives, he doesn't have enough money to pay it, so he makes the minimum payment – 10% of the balance owing, $149.80. He doesn't pay for the computer for three more months, except for the minimum payment each month.

1. If the annual percentage rate (APR) on his card is 18.9%, what's the true cost of the computer when it's fully paid? (Hint: Work out the monthly interest rate, calculate the added interest, and subtract the payments each month. Use an electronic spreadsheet if you choose, but be prepared to explain the formulas used.)

	Month 1	Month 2	Month 3	Month 4
Balance				
Interest at 1.58% per month (18.9% per year divided by 12 months)				
Subtotal (balance + interest)				
Minimum Payment (10% of balance)				
New Balance Owing (subtotal less payment)				
Final Payment				
Total (final payment + minimum payments + all interest payments)				

2. Calculate the cost of the sum of the items on your character's credit card statement, using the interest rate showing on the statement. Assume that your character makes only the minimum payments for three months.

You can find a variety of credit card cost calculators on the web like the one on the FCAC website (www.fcac.gc.ca, Resources > Tools and Calculators > Credit Cards Interactive Tools or the Credit Canada website (www.creditcanada.com/debtCalc.asp).

BORROWING MONEY AND MY FUTURE GOALS

Name: Class/Block: Date:

Borrowing money can be a good thing or a bad thing, depending on how you handle it. If you borrow wisely, debt is a valuable tool that helps you manage expenses over a period of time. It can be part of a strategy to help you achieve your education and career goals. But if you don't use debt with care, it can threaten your financial future.

So what do you do when your education and career goals are costly, and accumulating enough money to pay for them seems impossible? Borrow carefully! Keep these factors in mind:

TYPES OF CREDIT

There are many types of credit, with different features that make them appropriate in different conditions.

- **Credit cards** provide convenience for purchases or cash for short-term emergencies, but they can become very costly if not paid off quickly.
- **Student loans** charge a lower interest rate. But they can add up to very large amounts, and must be paid off when you leave post-secondary education. Carrying too much debt can seriously affect your future options.
- **Loans or lines of credit** from banks, credit unions and trust companies can pay for large purchases or pay down high-interest loans if you can comfortably fit the payments into your monthly budget.
- **Overdraft protection** is a short-term loan from your bank to cover debits or cheques when there isn't enough money in your account. It's convenient, but adds costs to your transactions.
- **High-cost loans** like paycheque advances or some of the deferred payment plans from retail stores may appear attractive, but they can be very costly. Their very high interest rates and fees can drain away your spare cash.

YOUR RESPONSIBILITIES WHEN YOU BORROW

- Borrow only what you can repay. Be sure you'll have enough income to make the payments when they're due.
- When you borrow money, you're making a legal commitment, so you should understand your credit contract before signing it. If you aren't sure what the contract means, ask the loans officer to explain it.
- Make the payments as agreed. If you run into trouble, don't avoid it – talk to the loans officer and explain the situation.
- Keep your cards, PINs and passwords secure, and check your credit slips and statements. You're responsible for reporting any errors.

BORROWING MONEY AND MY FUTURE GOALS (cont'd)

CREDIT RATING

- Before financial institutions extend credit, they try to assess your **credit rating**. This is a review of your ability to repay a debt, based on your character, income, economic history (employment, previous financial records, etc.), and assets (savings or other property).
- They often check with independent agencies, known as **credit bureaus**, for information about your history with other companies, like telephone companies and banks. Credit bureaus are companies that track people's credit history. With your consent, they share this information with companies you want to do business with. They charge the companies for access to your information.
- You may already have a credit rating! If you buy items online or by mail order or online services, the sellers may send a report to a credit bureau. And if your payments are behind schedule, your credit rating may be low.
- The better your credit rating, the more likely financial institutions will be willing to lend you money. If they consider you a good credit risk, they'll often offer a lower interest rate. If you have a poor credit rating, they may charge a very high interest rate, or refuse to offer a loan.
- You can request a copy of your own credit report from rating companies, and you can have them correct any errors in it. The main credit bureaus in Canada are Equifax Canada Inc. (www.equifax.ca) and TransUnion Canada (www.transunion.ca).

USING DEBT WISELY

Your decision to use debt, whether for short-term purchases or to finance your education and career goals, may have positive and negative implications for your future.

- Short-term implications. You don't have to wait to accumulate savings before moving toward your goals. But interest on debt adds to the cost, and you have to budget for regular payments.
- Long-term implications. You can achieve your goals earlier. But taking on debt limits your future choices, because you'll have to pay it back, which will reduce the money you have available for other options. Building a positive credit rating by using debt responsibly can make financing easier in the future. But a negative credit rating will limit your options in many ways.
- Because debt is expensive, the best financial strategy is often to *pay down debt as quickly as possible.*

You can pay in the short term, or you can pay in the long term, but you have to pay. The longer you put it off, the more you have to pay.

BORROWING MONEY AND MY FUTURE GOALS (cont'd)

WHAT CAN YOU DO TO AVOID DANGEROUS DEBT?

- Keep your credit rating positive. Pay your bills on time and don't take on debt you can't pay off.
- Go to reputable agencies like banks and credit unions for loans.
- Keep some savings ready for emergencies.
- If you run into credit problems, you can get free or low-cost advice from community and government organizations.
- Be on the watch for scams and rip-offs. You can get information about scams in your area from the Better Business Bureau (www.ccbbb.ca) and similar organizations.

ASSIGNMENT: CREDIT IN MY FUTURE

Fill in the following:

When I leave secondary school, I plan to:

____

If I borrow money or use credit to do this, it could affect my education and career goals. Some pros and cons to borrowing are:

Pros: ____

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Cons: ____

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So I'll manage my credit by: ____

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Discuss with your parents or another adult how you plan to manage credit in your transition from secondary school. Write a summary of your discussion.

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