FINANCIAL LITERACY

LESSON 11-25 ▲ PURCHASING WITH CREDIT

**LEARNING GOALS/OUTCOMES**

* Learn about using credit and establish credit rules for self.
* Identify a variety of sources of credit.
* Explain the costs and benefits of various types of credit.
* Differentiate between good debt and bad debt.
* Explain how a credit card is used to make purchases.
* Explain how credit card debt is repaid.

**MATERIALS NEEDED**

* **Student Handouts:**
* The Cost of Credit (Answer Key included with this lesson)
* Personal Rules for Credit
* Journal Page

**CLASSROOM ACTIVITIES**

1. **Students imagine applying for credit.** Ask students to imagine this scenario: you’ve just turned 18. With your birthday money and savings from your job, you can finally afford a big purchase you’ve been wanting for a year. At the checkout counter, the clerk asks if you want to apply for a store credit card. If you do, she tells you, you’ll get 20% off your purchase. You’re spending $500, so you would save $100! Plus, the card will come in handy because there are a lot of things you need to buy before college.

Ask for a show of hands. How many students would apply for the credit card in return for the $100 savings? How many would turn it down? Ask card takers what the benefits of a credit card would be. Ask card rejecters what the problems of a credit card would be. Record a list of their perspectives on the board.
2. **Students identify a variety of sources of credit.** Explain to students that getting credit means they are borrowing money so that they can buy something right now. Some people avoid credit and use savings to pay for new items. Many others use a variety of types of credit providers to purchase what they want right now.

Ask students to call out as many different kinds of credit as they can. Write their answers on the board. Students might identify bank credit, credit cards, car loans, home mortgages, student loans, home equity loans, retail credit programs, and cash stores as different types of credit. List the different types of credit providers on the board. Explain to students that credit providers make money by charging interest on the borrowed money. The more money you borrow, the more interest you pay. Some providers have higher interest rates than others.
3. **Students review the costs and benefits of various types of credit.** Distribute *The Cost of Credit.* Ask each student to complete the math for the four scenarios. After a few minutes, divide students into groups of three and have them compare answers. Ask students to reach consensus on which (if any) of the borrowing methods they would use to purchase the iPad. After a few minutes, have each group comment on the value of borrowing to buy right now.
4. **Students differentiate between good debt and bad debt.** Write the word “debt” on the board. Divide the class into two groups. Tell one group they have three minutes to come up with as many reasons as possible to explain why debt is bad. Tell the other group they have three minutes to come up with as many reasons why debt is good. Ask for one volunteer from each side to debate why debt is bad or good.

Explain that debt can be either good or bad. It depends on how it’s used and the terms on which it is obtained. Debt to purchase a home, for instance, is usually considered “good debt,” because the homeowners gain equity in their home as they pay it off over many years. But credit card debt is usually considered “bad debt,” because it is often accumulated for unnecessary things and carries a very high interest rate.

Ask students to look at the four scenarios from the handout. Ask for a show of hands on each scenario: is debt to buy an iPad good debt or bad debt?
5. **Students explain how a credit card is used and repaid.** Ask students if they know how a credit card works. Encourage students to recognize that you can use a credit card instead of cash. As long as you pay that money back to the credit card company within 30 days, you pay no money for the credit service! Ask students how credit card providers make money. Encourage them to recognize that too many people buy more than they can afford with their credit card, so they can’t pay it all back within 30 days. Credit card companies make money (at high interest rates) on people’s poor use of credit.

Tell the story of a college student who received a credit card as part of registering for college. She did not really understand how they worked. After buying all kinds of things, she ran her credit up to over $1,500. Her minimum monthly payments to the credit card company were $50. She was surprised to learn that her minimum $50 payments covered only the interest but did not reduce the amount she owed.

Distribute the *Personal Rules for Credit and Credit Worksheet*. Quickly review the facts on the first page, and then pause at the quiz at the bottom of the first page. Ask students to read the question and then answer it by checking one of the boxes. Then ask for a show of hands: how many students selected each answer?
6. **Students reflect on why they would or wouldn’t apply for a credit card to get major savings.** Tell students to think about the scenario you gave at the beginning of the lesson: that they have saved for a year to buy a $500 item, and now can get $100 off if they simply apply for a credit card. Ask them to use a *Journal Page* to answer these questions:
* Would I apply for a credit card if it would get me a discount on a major purchase?
* Why or why not?

**STUDENT PRODUCTS**

* **Completed *Cost of Credit* Handout**
* **Completed *Personal Rules for Credit* Handout**
* **Completed *Journal page*** on whether or not to apply for a credit card upon turning 18

FINANCIAL LITERACY

LESSON 11-25 STUDENT HANDOUT

 THE COST OF CREDIT

Simon has decided to purchase an iPad. After all the accessories and tax, Simon needs $945 to complete the purchase. He has $28 in the bank. He decides to borrow money to obtain the iPad right now.

**SCENARIO ONE: RETAIL CREDIT**

The computer store offers Simon an opportunity to purchase the iPad on their retail credit program. If Simon agrees to pay $40/month for the next three years, he can walk out with his purchase today.

On this credit program, how much would Simon pay in total for the \_\_\_\_\_\_\_\_\_

$945 tablet computer?

How much interest would Simon pay so he could have the iPad right now? \_\_\_\_\_\_\_\_\_

**SCENARIO TWO: BANK LOAN**

Simon decides to do some research before he makes his purchase. He goes to a local bank to find out what it would cost for a line of credit to buy the computer. He finds out it would cost 6.5%/year in interest. If the bank approves him for a line of credit, what would his costs be?

On this credit program, how much would Simon pay in total for the \_\_\_\_\_\_\_\_\_
$945 tablet computer?

How much interest would Simon pay, so he could have the iPad right now? \_\_\_\_\_\_\_\_\_

**SCENARIO THREE: CREDIT CARD**

The bank requires a person to be 18 years old and be earning $35,000 a year in order to provide a line of credit. Simon is 18 but has nowhere near that kind of annual income. So, Simon decides to apply for a credit card from the bank. If accepted, he will pay 18.5%/year, with a minimum payment of 3% of the amount he borrowed. If Simon’s credit card application is accepted, and he pays it off in two years, what would his costs be?

On this credit program, how much would Simon pay in total for the \_\_\_\_\_\_\_\_\_

$945 tablet computer?

How much interest would Simon pay, so he could have the iPad right now? \_\_\_\_\_\_\_\_\_

**SCENARIO FOUR: CASH ADVANCE LOAN**

Simon is rejected on his credit card application because he’s still in high school. He considers a money store, where they make cash advance loans available to anybody. He learns online that they charge $60 for each $200 you borrow and you have to pay it back in 15 days. If you fail to pay the whole amount, you pay another $60 for each $200 for the next 15 days. Assuming Simon borrows $1,000, and does not pay it back for 6 months, what would his costs be?

On this credit program, how much would Simon pay in total for the \_\_\_\_\_\_\_\_\_
$945 tablet computer?

How much interest would Simon pay, so he could have the iPad right now? \_\_\_\_\_\_\_\_\_

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LESSON 11-25 TEACHER HANDOUT

 THE COST OF CREDIT ANSWER KEY

Simon has decided to purchase an iPad. After all the accessories and tax, Simon needs $945 to complete the purchase. He has $28 in the bank. He decides to borrow money to obtain the iPad ‘right now.’

**SCENARIO ONE: RETAIL CREDIT**

The computer store offers Simon an opportunity to purchase the iPad on their retail credit program. If Simon agrees to pay $40/month for the next three years, he can walk out with his purchase today.

On this credit program, how much would Simon pay in total for the $1,440.00

$945 tablet computer?

How much interest would Simon pay, so he could have the iPad right now? $495.00

**SCENARIO TWO: BANK LOAN**

Simon decides to do some research before he makes his purchase. He goes to a local bank to find out what it would cost for a line of credit to buy the computer. He finds out it would cost 6.5%/year in interest. If the bank approves him for a line of credit, what would his costs be?

On this credit program, how much would Simon pay in total for the $1,071.84

$945 tablet computer?

How much interest would Simon pay, so he could have the iPad right now? $126.84

**SCENARIO THREE: CREDIT CARD**

The bank requires a person to be 18 years old and be earning $35,000 a year in order to provide a line of credit. Simon is 18 but has nowhere near that kind of annual income. So, Simon decides to apply for a credit card from the bank. If accepted, he will pay 18.5%/year, with a minimum payment of 3% of the amount he borrowed. If Simon’s credit card application is accepted, and he pays it off in two years, what would his costs be?

On this credit program, how much would Simon pay in total for the $1,326.99

$945 tablet computer?

How much interest would Simon pay, so he could have the iPad right now? $381.99

**SCENARIO FOUR: CASH ADVANCE LOAN**

Simon is rejected on his credit card application because he’s still in high school. He considers a money store, where they make cash advance loans available to anybody. He learns online that they charge $60 for each $200 you borrow and you have to pay it back in 15 days. If you fail to pay the whole amount, you pay another $60 for each $200 for the next 15 days. Assuming Simon borrows $1,000, and does not pay it back for 6 months, what would his costs be?

On this credit program, how much would Simon pay in total for the $4,600.00

$945 tablet computer?

How much interest would Simon pay, so he could have the iPad right now? $3,655.

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LESSON 11-25 STUDENT HANDOUT

 PERSONAL RULES FOR CREDIT

**WHY USE CREDIT?**

Paragraph body. People who borrow money use either short-term or long-term credit.

* Long-term credit is a loan you use to finance a very large purchase such as a home or car.
* Short-term credit – from a credit card – is also a loan and must be repaid.

A credit card can be useful. You can use a credit card to buy something immediately when you don’t have the money. You can use credit to track your purchases or to buy things over the Internet. But credit cards can also be dangerous, because they send a simple message: “Spend money.” And they let you keep spending even when you don’t have the money to pay back what you owe.

**CREDIT FACTS**

You will soon receive many credit card offers. But you need to be careful using credit:

* According to recent studies, the average college student has three credit cards and owes more than $3,000 in credit card debt (in addition to student loans).
* Every credit card you apply for is automatically added to your individual credit report. Too much credit card debt can make it difficult to buy a home or car.

**GOOD AND BAD USES OF CREDIT**

Credit cards have a number of good uses:

* They can provide identification (to rent a car or cash a check).
* They can be a safe substitute for cash.
* They provide easy record-keeping of your purchases.
* They usually come with insurance in case you are unhappy with what you bought.

But, credit cards can also be bad:

* They provide a constant temptation to spend.
* They have very high interest rates (if you can’t pay the full bill each month).
* They can allow you to accumulate a lot of debt very quickly.

**YOUR CREDIT REPORT**

What do you know about credit cards? If you are like the average college student and accumulate a balance of $3,000 on your credit card, at an interest rate of 17%, and you make the minimum payment each month, how long will it take you to pay off your credit card?

* 1 year
* 3 years
* 5 years
* 9 years
* 15 years

Mark your answer, then turn the page.

**YOUR CREDIT QUIZ – THE ANSWER**

If you are like the average college student and accumulate a balance of $3,000 on your credit card, at an interest rate of 17%, and you make the minimum payment each month, how long will it take you to pay off your credit card?

It would take you more than 9 years. To be precise, it would take 9-1/2 years to pay off your card, and during that time you would pay more than $2,000 just in interest… in addition to the $3,000 you originally put on your card.

**SET SOME CREDIT RULES**

Because it can be so difficult to get out of debt when that debt is on a credit card, it’s important to plan ahead and set some rules about how you will use credit. You will be 18 soon and able to get your own credit card. How will you use it?

**RULE 1:**

**RULE 2:**

**RULE 3:**

**RULE 4:**

FINANCIAL LITERACY

LESSON 11-25 STUDENT HANDOUT

 JOURNAL PAGE

**DATE:**

**Lesson 11-25 | *PURCHASING WITH CREDIT***

***Q1:*** Would I apply for a credit card if it would get me a discount on a major purchase?

***Q2:*** Why or why not?

***Answers:***