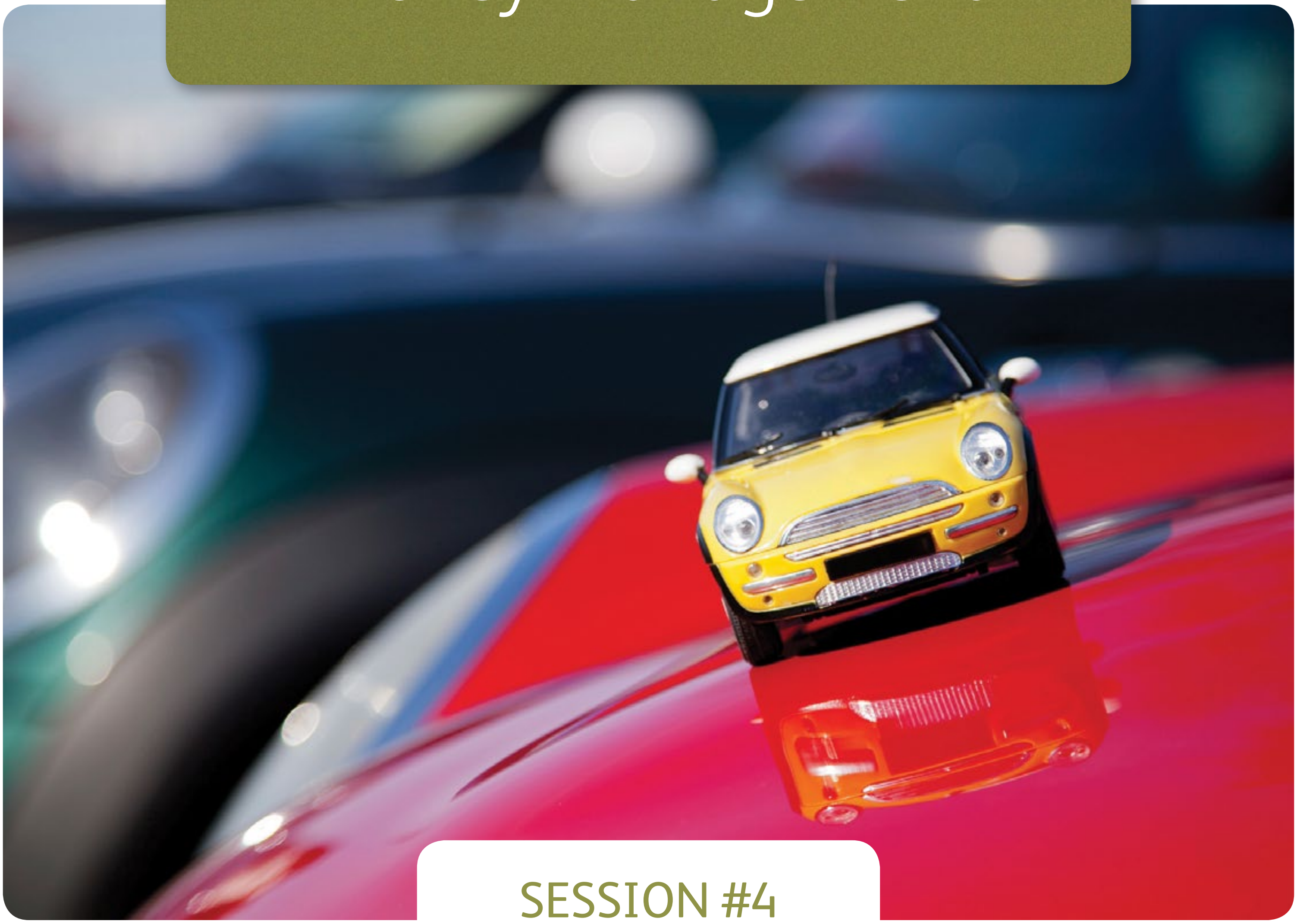
Money Management



SESSION #4

A NEED TO BORROW

The Money Management sessions have been developed for the HSBC Opportunity Partnership in collaboration with Catch22, St Giles Trust, The Prince's Trust, Tomorrow's People and **pfeg** (Personal Finance Education Group)

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A NEED TO BORROW

INTRODUCTION

The vast majority of people have a need to borrow money at certain points in their lives. Making sure this borrowing is both appropriate and manageable is a key financial skill. This session looks firstly at situations where borrowing may not be appropriate, before exploring the range of borrowing products available and the difference between them, along with which would be most appropriate for specific situations.

LEARNING OUTCOMES

By the end of the session the young people will:

- Understand the concept of good debt and bad debt
- Have considered the very high costs of payday loans and the alternatives that exist
- Know how to compare borrowing products effectively

RESOURCES

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Facilitator's Notes

Starter — SETTING THE SCENE — 10 Mins

- Explain that nearly everyone will need to borrow over the course of their lives. There are many reasons why people may need to borrow. Read out each of the scenarios in **Resource 1 – Good Debt or Bad Debt** and ask the young people to decide whether the money should be borrowed or not. Explain the concept of good debt and bad debt. Essentially, a good debt is one that will provide some kind of financial return, such as borrowing to buy a house or a car so you can get to work. A bad debt is one that provides no financial return at all such as borrowing to pay for a holiday or for a more modern music system.
- Highlight that even if the reason for borrowing is sound, if you would struggle to pay it back then borrowing is not a good option. Only borrow what you can afford to repay.

Core Activity — CREDIT HISTORY — 10 Mins

- Briefly look again at the scenario 4 from **Resource 1 – Good Debt or Bad Debt**. It says that the friend had been refused all borrowing from the bank. Ask the young people what the reasons for this may have been. Explain that all adults have a credit history which summarises any credit they have taken out and how well it was managed. Banks will use an individual's credit history to help make decisions on lending and the offer of other products. Explain that on reaching eighteen most young people will have a blank credit history as they have not yet borrowed and therefore cannot show how well they manage borrowing.
- Explain that if credit has been managed poorly in the past, such as missed payments or even bankruptcy, this will reduce an individual's credit score. It is important the young people understand that this can have a long term impact on their ability to borrow in the future.
- Credit histories are an area which young people often have misconceptions about. Understanding how a positive credit history is developed over time can be very useful for young people to understand.

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Facilitator's Notes

Core Activity

FORMS AND COST OF BORROWING

20 Mins

- If borrowing is needed then there are many different forms to consider. Ask the young people to mind map as many different ways to borrow as they can. They may come up with:
  - Family and friends
  - Secured loan
  - Personal loan
  - Credit cards
  - Overdraft
  - Payday loans
- Can the young people explain each of these different types of borrowing? Provide further information where required, and listen carefully for misconceptions. For example, young people can often be unsure of how a credit card is repaid, or what the difference between a secured and unsecured loan is.
- Explain that the cost of borrowing is determined by the interest rate charged and the length of time you borrow for. Ask the young people to try and arrange the different ways to borrow (listed above) into an order of the lowest interest rate charged to highest interest rate charged (the list is in the correct order above). Explain that all forms of borrowing are required to display the cost of borrowing as an Annual Percentage Rate (APR). This means all forms of borrowing can be easily compared.
- Discuss the fact that payday loans charge so much more interest than the other forms of borrowing (some payday loan companies charge over 4,000 % APR compared to an average of 22 % APR for an overdraft – the next highest form of borrowing). Ask the young people why they think people use payday loans if the APR is so high.
- Payday loans are a form of borrowing to which many young people have significant exposure without fully understanding the implications of the loan. Being able to understand just how quickly the charges and interest can build up on a payday loan can illustrate just how careful young people need to be with this form of borrowing.
- Discuss credit unions and how they can offer an alternative source of borrowing with much lower APRs.

  More information on credit unions can be found on the Money Saving Expert website www.moneysavingexpert.com/banking/credit-unions

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Facilitator's Notes

Core Activity

REVIEW

5 Mins

Recap on the learning objectives for the session and discuss with the young poeple whether they feel they now understand those learning objectives:

- Understand the concept of good debt and bad debt
- Have considered the very high costs of payday loans and the alternatives that exist
- Know how to compare borrowing products effectively

Core Activity

EXTENSION

15 Mins

Give out the situations in **Resource 2 – Best Way to Borrow**. Ask the young people to decide which the best form of borrowing is in each of the three situations. Take feedback and discuss the reasons behind their thinking (answers are provided in the **Resource 2 – Best Ways to Borrow – Answers sheet**.

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Facilitator's Notes

SESSION GLOSSARY

Annual Percentage Rate (APR)	The name given to the interest rate you will see advertised for any form of borrowing.
Budget	A way of planning for the money you have coming in and going out.
Credit card	A plastic card providing revolving credit up to a certain limit. It is used as a method of payment.
Credit score	A rating given to you based upon your financial history. Financial institutions use them when assessing who they should give credit to.
Credit union	Non-profit making organisations set up to provide saving and borrowing facilities to local communities.
Debt	Money that you owe.
Hire purchase	A form of credit used to buy relatively large goods. You pay back the cost over an agreed time period.
Mortgage	A financial product that enables many people to borrow the money needed to buy their own home.

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Facilitator's Notes

Overdraft	A borrowing facility on your current account that allows you to spend more than you have in the account.
Payday loan	A very short term form of borrowing with very high interest rates and penalties for missed payments.
Store card	A plastic card that provides credit on purchases in particular stores up to a certain amount. It is used as a method of payment only in the stores it is linked to.
Reward cards (also Loyalty cards)	A card which encourages shopping at one particular store or outlet by rewarding the consumer with points they can accumulate and spend in store instead of cash or discounted products.

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Resource #1

GOOD DEBT OR BAD DEBT

Scenario 1

Over the last year Lorna has been getting the train to work every day, but has worked out that a car would be a much cheaper option in the long run. She doesn't have the money to buy a car so would need to borrow the money to pay for it.

Scenario 2

Thierry went on holiday with friends last year to Blackpool and had a great time. This year they want to go abroad to Greece, which is quite a bit more expensive. He hasn't got the money and would need to borrow it.

Scenario 3

Ella has just bought a house with no central heating. The only way of heating it is using electric heaters in each room which are really expensive to run. Ella would need to borrow the money to install a central heating system, but reckons that what she saved on the electricity used by the heaters would cover the cost of installing the system in two years.

Scenario 4

Your friends have tried borrowing money from the bank and have been refused. They have recently had a baby and are finding it a bit tough financially. You don't have any money to give them at the moment, but wonder if you should try to borrow some so that you could help them out.

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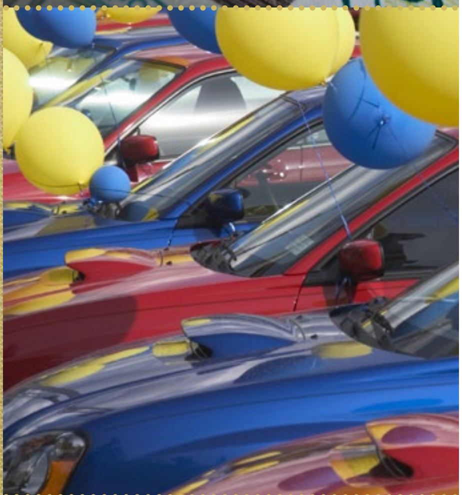
Resource #2

BEST WAY TO BORROW

Situation 1

Sian tries hard to plan ahead and has realised that next month she is going to have quite a few one-off expenses. Her income for that month will not cover what she expects to spend and she needs to think about the best way to borrow the money. In total she thinks the amount needed will be no more than £300. Her income each month is £1,200 and Sian is usually able to save around £100 every month.



Situation 2

Mo has recently found a new job, but it is twenty miles from his home. He needs a car in order to travel there and back each day. The car needs to be reliable and comfortable. Mo has savings of £2,000, but is looking to borrow £5,000 to add to this in order to get the car that suits his needs.

Situation 3

Will and Sarah have been living together in rented accommodation for the last five years. Now, with a baby on the way, they have made the decision to buy their own home. They have saved a deposit of £15,000 and are looking to borrow £110,000 to purchase a house they have seen. They would be looking to repay the debt over twenty five years.

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Resource #2

ANSWERS

BEST WAY TO BORROW

Situation 1

Sian tries hard to plan ahead and has realised that next month she is going to have quite a few one-off expenses. Her income for that month will not cover what she expects to spend and she needs to think about the best way to borrow the money. In total she thinks the amount needed will be no more than £300. Her income each month is £1,200 and Sian is usually able to save around £100 every month.

An overdraft facility would probably be the most convenient for Sian. Her borrowing requirement is relatively small, and this is more than covered by her income. Using an overdraft facility would mean that once her income was paid into the account each month it would clear the overdraft and she would only need to use the facility towards the end of the month. After three months she should no longer need to use the overdraft as it's mentioned that normally she could save £100 a month.

The young people may mention an interest free credit card. This is another good possibility. If an offer of 0% interest exists then this would be an even more cost efficient way of borrowing the money so long as it can be repaid within the offer period.

Situation 2

Mo has recently found a new job, but it is twenty miles from his home. He needs a car in order to travel there and back each day. The car needs to be reliable and comfortable. Mo has savings of £2,000, but is looking to borrow £5,000 to add to this in order to get the car that suits his needs.

A personal loan is Mo's best option. This allows him to repay the loan over a time period which is convenient for him. Borrowing via a credit card or an overdraft would cost considerably more.

Situation 3

Will and Sarah have been living together in rented accommodation for the last five years. Now, with a baby on the way, they have made the decision to buy their own home. They have saved a deposit of £15,000 and are looking to borrow £110,000 to purchase a house they have seen. They would be looking to repay the debt over twenty five years.

Will and Sarah would be looking at getting a mortgage, which is a form of secured borrowing. This form of borrowing allows for large amounts to be borrowed against the security of the property. The APR for secured borrowing is relatively low and this is because if repayments are not made the lender can get their money back by repossessing the property.

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Personal Finance
Education Group

The UK's leading financial education charity

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