$ Money Matters™

Handbook: The Cost of Borrowing

Learn what **you** need to know **quickly.**

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Money Matters Handbook: The Cost of Borrowing

Groceries cost. Clothes cost. Furniture costs. And it costs to borrow money.

The amount you see on the store price tag isn't always the full cost of buying an item. That changes with how you **pay** for it. Some ways of paying cost you more than others.

Money Matters is here to help.

Is this *Money Matters* Handbook for me?

If one or more of these statements describe you, then yes!

- ☐ Sometimes I can't afford to pay cash for what I buy.
- ☐ I don't always know how much I'm paying in interest and service charges when I use credit.
- ☐ I want to find out ways to cut back on the cost of borrowing.

Your Turn

- When you are short of cash, what do you usually do?

A Place for Your Notes

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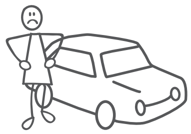
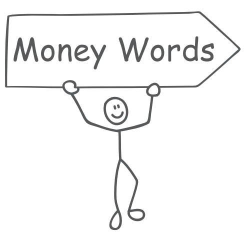


Jasmine's Story

Jasmine's car is in pretty bad shape! It recently broke down on the road, and the repairs cost her $845. She didn't have the money to pay cash, so used her credit card. Her car was fixed in no time, and she's back on the road.

Jasmine paid the minimum amount on her credit card for two months, and then managed to pay off the full amount she had borrowed.

When she did the math, she realized she had actually paid more than $900 for the car repairs, by the time she added in interest charges!



Credit is buying now and paying later.
You pay a **fee** when you use credit.
The fee includes **interest** and often **service charges**.

Your Turn

- Have you borrowed money on your credit card recently?
- What's your experience using a credit card?

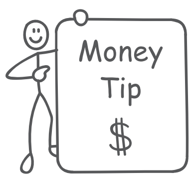
What's Your Story?

Your Money, Your Choice

When you need to buy or pay for something, you have choices.

Your choices make a big difference to **how much** you pay, and **how long** it takes you to pay back the money you borrow.

Same item, same sticker price. Different costs to you.

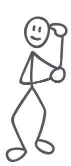


When you need to borrow money, **comparing the costs of borrowing** can save you interest and service charges.

Comparing Costs

You probably already do comparison-shopping when you make a purchase.

One store might sell the same pair of shoes for ten dollars less than another, so it makes sense to get the shoes at the store with the best price. The same is true when borrowing money.



Your Turn

- Do you compare prices when you shop?
- Do you do the same when you borrow money?

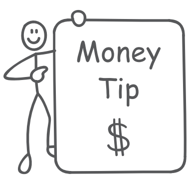
Your Money, Your Choice

Suppose you decide to buy a bed. You've found the one you want, and the store that offers it at the best price. Now it's time to **pay**.

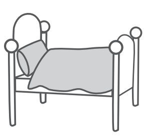
Let's look at some of the choices available to you, and compare the costs.

Paying Cash

If paying cash is an option for you, it is your best money choice. With cash, you'll know exactly what the item is costing you.

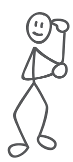


When you can, **pay with cash**. You won't be paying interest or service charges.



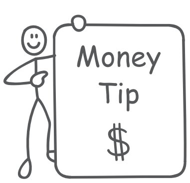
Store ticket price of the bed = $300 (taxes included)

Total cost of the bed when paying cash: $300



Your Turn

- Is there an item you're planning to buy?
- If you don't have the cash, can you save the money over time?



If you can't pay cash upfront, then make a plan to save the money.

Here's my plan for saving the money:

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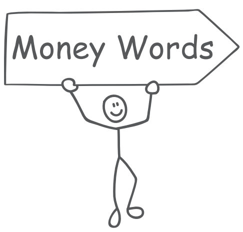
Your Money, Your Choice

When you can’t pay the total amount upfront, and you make a decision that you need the item now, then pay as much cash as you can.

Even a small amount will save you money in the long run!



A **loan** is money that you have borrowed. You agree to pay it back according to a **pay schedule**.

You also agree to pay **money added** to the amount borrowed, such as interest and service charges.

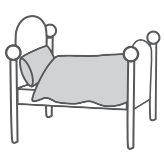
Paying Some Cash, Borrowing the Rest

Let’s say you save $100 to put towards the cost of the bed.

Store ticket price = $300
- Cash paid upfront = $100

Amount borrowed = $200

You’ll be paying interest on a $200 loan, instead of $300. That’ll save you money!



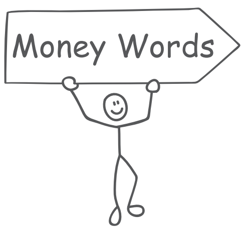
Total cost of the bed = $300 PLUS interest and services charges on the $200 loan.

A Place for Your Notes

Your Money, Your Choice

- Your first borrowing decision is to make sure that you want or need the item enough that you're willing to take out a loan to get it.
- Your second borrowing decision is to decide what kind of loan you'll take out.

A **credit card** is one kind of loan.



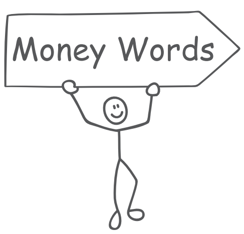
The **lender** is the person or organization that makes the loan.

Question:

When is a **credit card** a good choice for borrowing?

Answer:

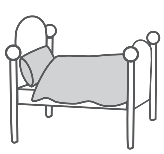
When you pay back the loan within the interest-free **grace period**. Then there is no interest charged.



The **interest-free grace period** is the time between taking out the loan on your **credit card**, and the first due date for the loan. It is usually a minimum of 28 days.

When you pay back the entire amount borrowed within the grace period, you won't pay interest.

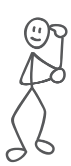
Let's say you buy the bed using your **credit card**.



You repay the amount you borrowed within the interest-free grace period.

Cost of the bed = $300

Interest paid: $0



Your Turn

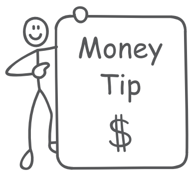
- Do you use a credit card?
- Do you pay the balance owing by the due date each month?

Your Money, Your Choice

All credit cards are not the same. Some have low interest rates, and others have high interest rates.

Some credit cards have extra fees. Some have penalties when you miss a payment.

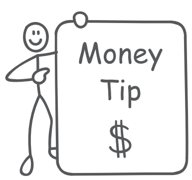
Bank credit cards, in general, have lower interest rates. Store credit cards, in general, have higher interest rates.



Borrow no more than the amount you can pay back each month on your credit card. Then you won't be paying interest.

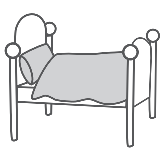
Low-interest Credit Card

When you can't repay the loan within the interest-free grace period, your best choice is a low-interest credit card. **Low-interest credit cards** are usually available through a **bank.**



Repay a loan as soon as you can. Interest charges increase the longer you take, and the bigger the balance owing.

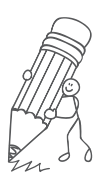
Let's say you buy the bed using a **low-interest credit card.** The interest rate is 14%. It takes you 90 days to pay off the loan.



You'll pay $102.34 per month for 3 months.

That's $7.01 interest.

Cost of the bed = $307.02



Try This

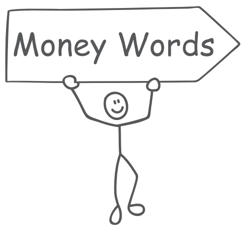
This **Credit Card Payment Calculator Tool** helps you compare three different options to pay off your credit card.

Your Turn

- How much can you afford to pay on a loan per month?
- What would you have to give up to make your loan payments?

Your Money, Your Choice

Interest rates are often much lower borrowing on a bank **line of credit** than with a credit card.



A **line of credit** is a loan that is pre-approved. You can use it whenever you need the money.

Line of Credit

A **line of credit** is a type of loan you set up before you need to borrow money. You can write a cheque or use a debit card against your line of credit to pay for something.

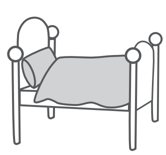
The Good:

Low interest rate, the loan is ready when you need it!

The Bad:

Interest is charged from the day you borrow the money. There is no interest-free grace period as with a credit card.

Let's say you use a **line of credit** to buy the bed, and pay the loan back in 90 days. The interest rate is 10% per year, and there are no service fees.



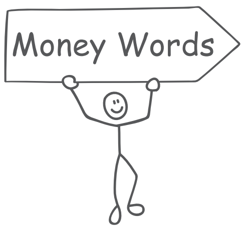
You'll pay $101.67 per month for 3 months.

That's $5.01 interest

Cost of the bed = $305.01.

Your Money, Your Choice

Another choice is to set up **overdraft protection** on your bank account.



Overdraft protection is a type of loan on your bank account.
It's a "safety net" for when the account is overdrawn.

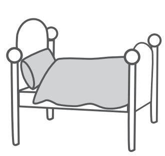
Overdraft Protection

With **overdraft protection,** the bank lends you the money to cover a shortfall in cash. When you don't have enough money in your account to cover a cheque, or another charge, the bank pays it.

The Cost to You

- You might pay a fee for overdraft protection on your account, such as a yearly fee.
- You pay interest charges on the overdrawn amount. The interest rate is usually higher than a line of credit or a low-interest credit card.
- There is no interest-free grace period.

Let's say you pay for the bed using overdraft protection. The interest rate is 21% and it takes you 3 months to bring your bank account back to the "plus" side, that is, to pay off the loan.



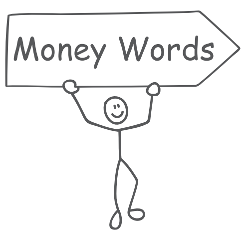
You'll pay $10.56 in interest.
Cost of the bed = $310.56
PLUS bank fee, if there is one

Your Money, Your Choice

Sometimes stores offer credit deals like “don’t pay for 60 days” or “no interest for a year!”

The catch:

- There might be **service or administration fees.**
- If you don’t pay within the time period, **high interest rates** often kick in.
- These interest rates are calculated from the **day you bought the item.**

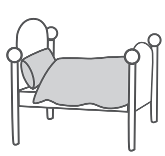


Be careful when agreeing to pay service or administration fees. Sometimes the amount is **more than you’d pay** with a higher interest rate!

Store Credit Cards

Many stores offer **store or retail credit cards.** The interest rates are often higher than bank credit cards.

Let’s say you buy the bed on a **store credit card** with a special offer. The loan is interest-free for 60 days, then you pay 29.5% on the balance owing, going back to the day you bought the bed. Because of a family emergency you haven’t been able to pay off the loan. Ninety days have now passed.



You owe $14.85 in interest fees – more than 2X the interest for the low-interest card, and 3X the interest for the line of credit!

Cost of the bed to date = $314.85

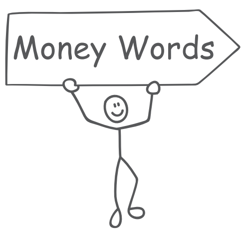
If you’re unable to pay off the balance, the interest fees will continue to rise!

Your Money, Your Choice

You've probably noticed that lenders offering payday loans and quick cash advances are setting up business in places that look like storefronts.

Payday Loans

Payday loan businesses offer quick cash, but they have very high fees. You have a short time to pay back the loan.



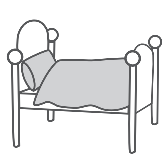
A **payday loan** is a short-term loan.
You write a cheque to pay back the full loan amount, plus interest and service fees, dated for your next payday.

Borrower Beware!

Some payday loans appear to be a good deal because they don't have interest charges. Don't be fooled! Instead of interest on the loan, you pay set-up or service fees. The fee is **much higher** than the interest charges for other ways of borrowing.

If you don't have the money on your next payday to repay what you owe:

- You might have to pay high interest rates on the loan balance, including the set-up and processing fees.
- You might be able to "roll" the amount you owe into a new payday loan to pay off the previous loan, with more set-up and processing fees.
- Your loan might be turned over to a debt collector.



Let's say you take out a payday loan for $300 to pay for the bed. You pay if off from your next paycheque, but you have also paid set-up and processing fees of $40.

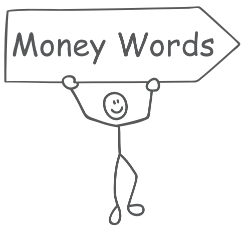
Cost of bed is $340 ($300 + $40 fees)

Comparing the Costs of Borrowing

Let's now compare the costs based on how you paid for the bed.

The total cost of the bed =

Principal + interest and other fees



The **principal** is the money that is lent to you.
The **term** is the length of time of the loan.

Ways of Paying	Term (length of time of loan)	Principal (money borrowed)	Interest and other fees	Total Cost of the Bed
Cash		$0	$0	$300
Credit Card	Paid back in full **before** the interest-free grace period is over	$300	$0	$300
Line of Credit @ 10%	3 months	$300	$5.01	$305.01
Low-interest credit card @ 14%	3 months	$300	$7.01	$307.02
Overdraft @ 21%	3 months	$300	$10.56	$310.56
Store Credit Card @ 29.5%	3 months	$300	$14.85	$314.85
Payday Loan	Next payday (2 weeks)	$300	$40 in fees	$340

Your Turn

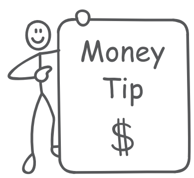
Do you plan to borrow money to make a purchase?

What I'd like to buy: ____________

What it costs: ____________ (including taxes)

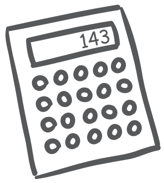
Money I'd borrow: ____________ (principal)

Comparing the Cost of Borrowing to YOU



Use an online loan calculator to figure out the cost of borrowing. Here's the link to the **TD Canada Trust Personal Loan Calculator**.

If I used…	Interest rate per year	Term of loan	Service fees	Total Cost of the item
My Credit Card				
My Line of Credit				
My Overdraft				
The Store Credit Card				
A Payday Loan				
Another Way: ____________				

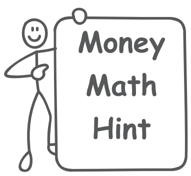


Do the Money Math

Want to do the math yourself to figure out how much you'll pay in interest charges? Use this formula.

$$\frac{\text{Annual interest rate} \times \text{Term (in days)} \times \text{Principal}}{\text{365 (days in a year)}}$$

$$= \text{Interest Charges}$$



Write the annual interest rate as a **decimal** instead of a percentage.

For example: write **29.5%** as **.295**

Your Turn

How much will you save if you pay cash for the item instead of borrowing?

A Place for the Math

Learning More

Visit **www.financialliteracyweek.ca** to learn more about financial literacy and math skills through access to tools, resources and community events and celebrations.

There are many online loan calculators that can help you figure out the monthly payment of a loan and total costs of borrowing. Try the online TD Canada Trust **Personal Loan and Calculator.**

Visit the **Financial Consumer Agency of Canada (FCAC)** online to learn more about credit cards, payday loans, and other information about loans and borrowing money. Website address: **www.fcac.gc.ca.**

Check out the FCAC website to access **Credit Card Interactive Tools**, including a Credit Card Selector Tool, Credit Card payment Calculator, and Credit Card Quiz, along with several publications for more information.

A Place for Your Notes