



Credit ~ Next Steps
Participant's Guide



About Bank On

Bank On Hampton Roads is truly a unique experience. Like a wellness plan for your finances, Bank On Hampton Roads offers all the education, support and encouragement you need to launch your financial plans. In this five month program, participants are encouraged to take the financial challenge to:

- Increase Income
- Grow Savings
- Reduce Debt
- Improve Credit Score
- Protect Assets

The way Bank On Hampton Roads works is you attend one class per month and meet with a personal financial coach once per month. In class you will learn some of the strategies for overcoming paycheck to paycheck living and speedy ways to reduce debt and see your savings grow. As you meet with your financial coach, you will build a financial plan centered on your goals and your dreams. With the combination of knowledge and improved financial management techniques, you can see your dreams become reality!

Bank On Hampton Roads is one of over 70 programs across the United States organized to improve your financial opportunities by building relationships with trusted financial partners and empowering you to take greater financial control.

Classes begin in February and September and the program is absolutely free to the participant.

Many of Bank On Hampton Roads resources are available online at www.bankonhr.org.

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Welcome

Welcome to the *Credit - Next Steps* module! In this lesson we will learn action steps to take in order to improve your credit as well as some of the providers who might hinder our progress by offering a quick fix to our financial needs.

Objectives

After completing this module, you will be able to:

- Understand how a debt snowball works
- Define predatory loans
- Identify certain types of predatory loans
- Identify alternatives to predatory loans

Participant Materials

This *Credit - Next Steps* Participant's Guide contains:

- Information to help you learn the material
- Actions to take to get out of debt and build credit
- Actions to avoid borrowing unnecessarily
- Actions to take to report a predatory lender
- A sample debt snowball
- Examples of predatory loans
- A sample debt snowball
- Glossary of terms

Pre-Test

test your knowledge about credit

1. Problems with predatory loans can include: (Select all that apply)

- a. High annual percentage rate (APR)
- b. High fees
- c. The need to pay off the loan in a short time period
- d. Puts the collateral (asset used to obtain the loan) at risk

2. Paying the minimum payment on a credit card every month will:

- a. pay a large percentage of the total balance owed every month
- b. mean that the final amount paid is much higher than the initial cost
- c. allow the cardholder to avoid paying any interest charges
- d. mean that the charge will be paid off in a decent amount of time

3. What sources for a loan tend to have lowest interest rates?

- a. Payday lender
- b. Cash- advance lender
- c. Credit Union or Bank
- d. Car Title lender

4. Before accepting a loan you should: (Select all that apply).

- a. Consider whether the item is a need or a want.
- b. Make sure you can afford the loan
- c. Check to make sure the loan provider is reputable
- d. Obtain loan quotes from other lenders than compare all terms and conditions

5. What is the most important step to paying off debt?

- a. Refinancing for a better interest rate
- b. Stop creating new debt
- c. Pay off debt before saving money
- d. Paying off the lowest balance first

Credit Next Steps

Welcome to *Credit ~ The Next Steps*! We've learned the basics of credit, so now we're going to talk about some of the more in-depth aspects to borrowing money. Today, we will add to our discussion on credit from last month. Here are some of the topics we will discuss:

- **Making wise credit decisions** allows you to build your credit score while avoiding the burden of mounting debts. Limiting our use of credit cards keeps us from racking up balances we can't afford to pay off.
- **Assessing credit offers:** We will talk about the importance of shopping for credit, like you might shop for other products. Knowing how to review the terms of credit offers allows you to use credit without having an unwelcome surprise. Knowing how to compare credit offers allows you to get the best deal suited for you and your lifestyle.
- When we absolutely must get money for an unexpected need, it is important that we **know where to go**. We will talk about finding funds when you need them.
- **Building Credit:** Whether you are establishing credit for the first time or recovering from lower credit scores, all of us want to have a rising credit score. We will discuss strategies you can use to build your credit score.
- **Predatory traps:** There are businesses out there that would take advantage of people with credit challenges. We will talk about how they operate and how you might avoid falling into their trap.
- **Debt consolidation** is often something people explore when getting out of debt. We will help you with some strategies you can use.
- **Resources for debt payment:** If you need help getting out of debt, we will share with you some organizations that can help.
- **Paying down debt:** Finally, we will discuss how a debt snowball works and how you can make one work for you.

Making Wise Credit Decisions

When deciding whether to finance a purchase, it is important to evaluate whether the purchase is really necessary. We can easily accumulate debt when we make unnecessary purchases on credit.

Impact of Culture: We live in a culture that seeks immediate gratification. It is easy to be influenced by the culture, but the culture won't make the payments for you and won't help you reach your goals.

Needs vs. Wants: We talked about needs and wants in the Money Management lessons, but this concept also applies to our credit decisions as well. Begin by committing to use credit only if the purchase is a need. Wants can be deferred until the cash is available. If it is a need, it is worthwhile to consider what will you sacrifice to make this purchase now.

Reduce your time in debt: You want to minimize the amount of time it takes to repay the purchase, so our monthly spending will be impacted.

Reduce the amount of debt: Can you reduce the amount of money you borrow by applying some of your savings? Perhaps the entire purchase, while necessary could be delayed until the money can be saved in full.

Explore alternatives to debt: Sometimes, the purchase may be a need, but, even then, you can find alternatives to minimize the amount that needs to be financed. You can find a used item using some of the social apps that allow people to sell their things at a bargain to you. Thrift stores and other resale locations can allow you to have the thing you need without having to pay retail.

Assessing Cost of Credit

Last month, we discussed knowing the cost of credit. Not all credit offers are the same. It is important to review offers and know how charges are assessed for services offered. The marketing may highlight a great interest rate, but do they have other ways of getting paid?

Financial Institutions are required to provide Truth in Lending Disclosures to give you uniform information to assess credit offers. With this information, you will be able to compare the actual cost of borrowing.

There are two basic ways creditors get paid; fees and interest.

Fees can sometimes be even more than the interest that is charged. These fees are detailed in the truth in lending disclosures.

Interest: The other way lenders receive money is through interest. We talked about APR in the last lesson. We said that this is a rate of interest expressed as an annualized percentage that includes the effect of compounding and additional fees.

Penalties: More practically, as you look at the terms of a credit offer, the Truth in Lending disclosures will outline for you the penalties that may be assessed if things do not go as planned. Rarely do we read these disclosures related to penalties, because we don't anticipate that things will go wrong. We should take a look at things like, late payment penalties and actions the financial institution may take if the loan is not repaid as agreed.

Shopping for Credit: Beyond the nominal interest rate, we can also save ourselves significant costs related to borrowing if we shop around for less expensive credit offers. For instance, I may need to purchase a car for transportation, but the cost of financing through a buy-here/pay-here dealership is significantly more than if I am able to finance with my credit union or bank. Some of our Bank On financial institutions even have special car loans for people with less than excellent credit to keep them from falling into high interest loans that can cripple them financially. This is also where we can apply our wants/needs analysis to determine how much of a car I really need. We need reliable transportation, but some of the additional features might be able to be eliminated to keep our costs lower.



Have you ever seen the ads on TV that make it seem like payday loans are the thing to do if you are short on cash till payday? Or to use your car to get a loan to go on vacation? When the money seems to be easy to get, beware of the “strings” that are often attached. Getting a little extra cash to buy food before your paycheck is deposited seems reasonable. Unfortunately, it’s the loan practices of some storefront lenders like payday lenders, that make them predatory in nature. Before seeking out quick loan solutions from alternative lenders, consider other ways you might be able to get some cash when you need it:

Savings: Savings is our security blanket when the unexpected happens and we need some extra money. We want to keep savings secure, but if the money is needed, you can always “borrow” from your savings account and repay later.

Salary Advance: Some employers may offer the option of a salary advance at a lesser cost than payday or title lending.

Your bank or credit union may have some personal loans or refinance options that may allow you get some additional money to pay for your needed purchase.

Social service agencies offer food and cash assistance for people in need. Many of the programs are government subsidies, so there are eligibility requirements. If you think you might be eligible, check out our resource guide on the Bank On website to learn more about the programs that might help you.

211: Just dial 2-1-1 for a referral operator who can direct you to non-profit resources in your community. This service is available 7 days a week, 24-hours per day.

Family, Friends or Religious Institutions: Other resources might include, going to a relative, friend or your religious institution to ask for funds to get you through your crisis.

Cash Advance: Finally, while there may be fees for a cash advance on your credit card, the terms will likely be more favorable than payday or title lending. With a cash advance, you have greater time to repay if you truly need emergency cash.

Building Credit

One of the best ways to reduce the cost of credit is to improve your credit score. More and more providers are now offering products to help you build your credit even if you have had credit issues in the past. Let's talk about some of these products and strategies you can use:

Secured credit cards: These products allow you to deposit funds with your financial institution, they offer a credit limit based on the amount deposited. These deposited funds are not used to make payments, but they provide the financial institution with security in the event that payments are not made. When you use this credit limit and make payments, they report to the credit reporting agencies and this can help to build your credit profile with positive payment history.

Key benefits of a savings secured loan:

- Start with loan amounts as low as \$500
- Payments can be automatically deducted from account
- There is no risk to the bank or credit union since the money you deposited can pay the loan if you default
- Payments made are reported to credit reporting agencies to build your credit score.

Credit Builder account: Credit builder accounts are offered as a way for you to build your credit. With this product, no actual loan proceeds are received, but you make a commitment to make regular monthly deposits into a savings account that is frozen during the time of the contract. The savings deposits are recorded as loan payments to credit reporting agencies.

Authorized user: Have you ever wanted to use someone else's good credit for yourself? Becoming an authorized user on their credit card can be a great thing for you. The primary card holder is still responsible for making payments and as they do, the payment history is also reported on your credit report as well. Because you are an authorized user, you have access to this credit account; be careful to communicate when you are accessing someone else's credit and be sure to take responsibility for repaying amounts used.

Cosigner on a loan: For people who otherwise would not be approved for a traditional loan may be able to gain access using a cosigner. If someone with strong credit is willing to lend their endorsement, the financial institution may be willing to extend the loan to you. Warning: if you do not make your payments on time, the cosigner will be responsible to bring the loan current. At that point, the loan is past due and both you and the cosigner will receive the negative report on your credit report. Cosigning can help you build a credit history, but can also potentially damage a good relationship.

Predatory Lending

Predatory lending typically describes unfair, deceptive or fraudulent lending practices. While there is no legal definition, a good rule of thumb is “imposing unfair and abusive loan terms on borrowers.” Predatory lenders grant credit regardless of your credit history or your ability to pay, often with really negative results. Predatory lenders often have higher costs of borrowing and can be aggressive in their collections practices.

Predatory lenders:

- prey on the vulnerable and desperate. They offer a quick solution to a financial crisis that often leads to an even worse situation.
- are one of the most serious threats to lower-income families and minorities. In certain areas, there are more predatory lenders than there are federally insured banks and credit unions.
- often wreaks havoc on your finances. Once you’re caught in the predatory lending trap, it can be difficult to get out. Not impossible, though! We’ll talk about this in a minute.
- can make it difficult to get reasonable loan terms in the future because it can destroy your credit score.

Abusive practices can occur in the mortgage, home equity, credit card, auto lending, and payday lending markets. Most of the problems are not caused by federally insured financial institutions.

The Consumer Financial Protection Bureau has implemented a complaint database that consumers can use to record any mistreatment they may have experienced by lenders. <https://www.consumerfinance.gov/complaint/>



Payday Loans

The payday loan industry advertises these loans as quick and easy ways to get cash, and targets lower-income working consumers, including welfare-to-work women and others who have little to no savings and live paycheck-to-paycheck.

Most cash-strapped borrowers who get payday loans are not able to repay the whole loan within two weeks and end up rolling over their loan and paying renewal fees multiple times. More than 3/4ths of all payday loans are made to borrowers who have paid off a payday loan within the prior two weeks.¹

Small Cash Advances: Most payday loans are small cash advances, \$500 or less.

Short-Term Loan: In Virginia, the length of a payday loan is usually two pay cycles. Your participant guide offers more information about Virginia payday loan regulations. Most cash-strapped borrowers who get payday loans are not able to repay the whole loan within two pay cycles and end up getting a new loan to repay the initial payday loan. Consumer Financial Protection Bureau (CFPB) research indicates the majority of borrowers take out at least 10 loans in a row². Trapped on this "debt treadmill," borrowers typically pay much more in fees than the amount originally borrowed.

Payment: At the time of the loan, payday lenders will request either a post-dated check or authorization to automatically draft the payment from your checking account on the due date. CFPB found that half of payday and payday-installment online borrowers have at least one debit attempt that overdrafts or fails. These borrowers incur an average of \$185 in bank penalty fees, in addition to any fees the lender might charge for failed debit attempts, specifically, a late fee, a returned-payment fee, or both². In addition, many borrowers find that their financial institution may automatically close their checking account after failed attempts of lenders to draft payment; this closure impacts a borrowers ability to pay other obligations.

Fees: The fees they charge are based on the amount borrowed and, over time, can mean an APR (annual percentage rate) of 195% to 836%. The usual cost is \$15 for every \$100 borrowed.

Rarely do the lenders advertise their APR, but in your loan document the full APR for charges must be disclosed. The lender is allowed to charge up to 36% simple interest on the loans, 20% loan fee and a \$5.00 verification fee. These layered fees can result in a very high APR for a short loan.

In 2017, CFPB implemented new requirements for payday and title lenders to keep consumers from becoming trapped in a debt repayment cycle, including validation of ability to repay the loan along with basic living expenses².

Why do payday lenders charge so much? Payday loans carry substantial risk to the lender. Payday lenders have a default rate of approximately 15%. Defaults cost payday lenders approximately 25% of their annual revenue.¹ Concerns over high costs, and the targeting of vulnerable citizens has led states to regulate payday lending.

¹ <https://www.kansascityfed.org/publicat/econrev/pdf/11q1Edmiston.pdf>

12² https://files.consumerfinance.gov/f/documents/201710_cfpb_fact-sheet_payday-loans.pdf

Virginia State Corporation Commission offers a consumer guide to payday lending that has some great information. https://scc.virginia.gov/bfi/files/pay_guide.pdf.

Military members are offered additional protections against payday lenders. Military members should contact the financial counseling programs available through their commands to learn of the protections available to them.

Tax Refund Anticipation Loans

Tax Refund Anticipation Loans (RALs) or Tax Refund Anticipation Checks offer a loan against an anticipated tax refund. Some are marketed during the holidays to provide cash for travel, gifts or other expenses.

Short-Term Loan: These are short-term cash advances against a customer's anticipated income tax refund.

No Interest Loans: The loans may state "no interest or no fees", but in reality, the cost of the loan may be embedded in the tax preparation fees charged. They claim to get you money faster, but in reality, they only speed up the refund process by about a week, compared to what consumers can expect by filing online and having their refunds deposited directly into their banking accounts.

Cost: These lenders particularly target families eligible for the Earned Income Tax Credit and the Additional Child Tax Credit. Seventeen million RALs and 20.5 million refund anticipation checks were issued in 2017¹ Refund anticipation loans and checks can add up quickly easily eating away 10% of your refund or more.² The Center for Responsible Lending reports that 87% of taxpayers who applied for an RAL in 2009 were low-income, so you can see how the vulnerable are inordinately affected.

IRS is not involved or responsible for refund anticipation loans. Providers of RALS do have some disclosure requirements and limitations to fees and advertising. Violators can be sanctioned by the IRS. If your refund is not as large as expected, part of it may have been seized for back taxes, child support or a student loan that is in default, you have to repay the difference.³ Many people have already spent the money and have a hard time repaying the loan.

¹ <https://www.nclc.org/media-center/new-generation-tax-time-loans.html>

² <https://credit.org/2018/02/16/why-refund-anticipation-loans-are-still-bad-news>

³ <https://www.irs.gov/e-file-providers/tax-refund-related-products>

Title Loans

Title loans are big business for these lenders providing \$8 billion in fees annually.¹ Although car title loans are marketed as quick and easy solutions to a financial emergency, using this product may only worsen financial problems for borrowers. Car title lenders generally require you to have a free and clear title to the car before giving you a loan.

Short-Term Loan: The payment on a title loan is generally required 3 months to one year.

Vehicle At Risk: Your vehicle serves as collateral for the loan and may be repossessed if you are not able to make your payments. For most consumers, the loss of a car brings new challenges like how to reliably get to work, to a doctor, or a grocery store. If your car is lost to the title lender, additional fees like storage fees and resale fees can be assessed. Once the car is sold, the borrower might still be responsible for any costs that were not completely covered with the proceeds from the sale.

Loan to Value Ratio: The lender then decides how much you can borrow, based on the vehicle's value. Usually, the amount of a car title loan is much less than market value for the car. Consumer Financial Protection Bureau estimates that the loans offered are between 25 and 50% of the market value of the car.² The length of a car title loan can vary from as short as 10 days to a month or even longer. Just like a payday loan, car title loans require full repayment.

Cost: This loan uses a borrower's personal vehicle as collateral and additionally charges triple-digit interest rates, like those of payday loans.

On average, a person renews their title loan eight times. On a \$500 title loan, this average customer will pay back \$650 in interest over eight months. That's in addition to the original \$500.³

As with payday lenders, military members have additional consumer protections. Military should seek out their financial counseling programs available through their commands to learn of the additional protections they may have.

Virginia Legal Aid Society offers information that is very helpful to consumers. Their guide to car title loans offers more detail related to your rights and responsibilities with title loan companies.

<https://www.valegalaid.org/files/E095B726-FCD8-81C1-17DC-A16C7ED73FFF/attachments/B151810D-FB83-19B7-96FF-ACF7E3A561F5/car-title-loans.pdf>

https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl_statebystate_fee_drain_may2016_0.pdf

<https://www.consumer.ftc.gov/articles/0514-car-title-loans>

<https://www.responsiblelending.org/media/cfpb-car-title-loan-research-exposes-sky-high-levels-car-repossessions-and-extent-debt-trap>

Other High Cost Sources of Loans

Other high cost sources for funds can include some of the providers we mentioned earlier in the lesson like rent to own, buy here/pay here, pawn loans and cash advances.

Rent to Own: While rent to own providers may not be providing you cash in your time of need, they do provide people without a lot of cash or available credit the ability to furnish their homes. The high cost of these purchases influenced the Department of Defense to label rent to own as a predatory practice, defining it as an "unfair or abusive loan or credit sale transaction or collection practice,"¹ Most transactions end up being returned prior to the fulfillment of the purchase contract.

Buy Here/Pay Here: These dealerships market to consumers who otherwise would not be able to finance a car through a traditional financial institution because of poor credit. With nearly 10% of all vehicles purchased through these dealerships, they significantly impact our community. The costs can be very high, with interest rates sometimes exceeding 30%. What's more, your payments may not be reported to the credit reporting agencies. This means that even if you pay on time and in full, you may not be building your credit score. Some Bank On financial institutions offer special financing for auto loans to help you build your credit and not pay the high cost of buy here, pay here. It is estimated that 25% of all buy here/pay here loans will default², putting these buyers at-risk of losing their transportation to work.

Pawn Loan: A pawn loan may appeal to consumers who don't have good credit and need quick cash. The good news is that pawn loans can be less expensive than a payday loan or a title loan, but even so, interest rates can top more than 100% APR. What's more, about 15% of the borrowers are unable to repay the loan and have to forfeit what they offered as collateral.³

Credit Card Cash Advance: a cash advance from your credit card can allow you to use an ATM to borrow cash. Unlike getting cash from your bank account, this loan must be repaid. Some cards have a flat fee for cash advances, and some charge a percentage based on the amount borrowed. Often, there is a higher interest rate applied to amounts that are taken as a cash advance and interest starts accruing immediately. With cash advances, you are likely paying a fee to get the money from your card, you may also pay an ATM fee, then you pay interest on the funds.⁴ Some cards in their disclosure statement will let you know that when you make your credit card payment that the payment is applied to the lowest interest purchases first and then to the higher interest cash advance loans, so you will never repay the high interest debt until you pay your balance in full. This can be a costly way to access funds, so before using a cash advance, consider the costs.

¹https://web.archive.org/web/20111018124500/http://www.defense.gov/pubs/pdfs/Report_to_Congress_final.pdf

²<http://www.governing.com/blogs/view/putting-the-brakes-on-buy-here-pay-here-car-dealerships.html>

³<https://www.nerdwallet.com/blog/loans/pawnshop-loans/>⁴<https://www.nerdwallet.com/blog/credit-cards/what-is-a-cash-advance/>

Debt Consolidation

A debt consolidation loan allows you to refinance your debt into one monthly payment. This monthly payment can be financed as either secured debt or unsecured.

A secured loan might be the refinancing of a car or your home or an equity line of credit. As with any secured loan the asset that secures the loan is at risk, so if you aren't able to make payments, you could lose that valued asset.

With unsecured loans, credit card companies often offer low interest or no interest transfers to get you to refinance your credit card debt with them. While there may be no interest for a period of time, there may be fees associated with a balance transfer aside from any interest charges, so you will want to read the disclosures carefully. This low rate is usually only on balance transfers, new purchases receive the going interest rate. Also, the low rate is offered for a set period of time and only if you make your payments on time.

Many financial institutions will offer debt consolidation loans or equity refinance loans to help you consolidate debts. These loans could have some fees in addition to the interest charged, so be sure to ask good questions and read the disclosures provided with the loan.

In addition to traditional loan providers, there are some other sources you may want to think about if you need debt consolidation. You may want to work with a non-profit credit counseling organization. Some of these organizations do offer debt repayment plans for a small fee.

Family and friends may be a source of funds, but if you choose to use a trusted relationship, there could be relationship issues if you don't honor your commitment. Any arrangements should be written so that there is no confusion about the terms. If you ask a relative to cosign or to take a loan out on your behalf, you could also be putting their finances at risk.

It may be tempting to tap your retirement funds when you need some help, but you should consider this a source of last resort. There are two ways to tap retirement funds. Some retirement accounts will allow you to borrow your own money for certain allowable purposes without penalty. You repay your own retirement with interest. During the time of the loan, you may lose some of the potential gain you would have received if you had remained invested. Also, if you leave your employer before the loan is repaid, that money will be considered withdrawn and penalties could apply.

If you choose to withdraw funds from your retirement, you should be aware that there may be a 10% penalty if you withdraw before age 59^{1/2}. That penalty is paid when you file your taxes.

Regardless of the source of funds or type of loan, if you stretch out your monthly payments over a longer loan period, you will most likely pay more interest for that same debt than if you maintained the existing payment plan.

<https://www.creditkarma.com/credit-cards/i/ways-to-consolidate-credit-card-debt/>
<https://www.nerdwallet.com/blog/finance/consolidate-credit-card-debt-personal-loan/>

Debt Consolidation (Cont'd)

When the monthly payments for debts are beyond what we can reasonably afford, it is tempting to consolidate debts into one monthly payment and stretch those payments out over a longer period of time. But a quick fix can have consequences. Consolidation could be a temporary fix that could result in an even bigger problem in the long run.

If the borrower doesn't address the actions that got them into debt in the first place, they may end up with even more debt down the road. Consolidation doesn't address the ongoing use of credit cards for monthly purchases. If you continue to use credit card debt, you may find that you have a debt consolidation loan AND a growing credit card balance.

CAUTION: According to a source for Bankrate.com, 70% of Americans who consolidate debt find themselves in worse shape within two years.¹

¹ <https://www.bankrate.com/finance/debt/dangers-of-debt-consolidation-1.aspx>

Getting Help

If you need help to get out of debt, you should check out the resources that are provided on the Bank On website under their Resource Guide.

Credit Counseling can help you overcome debts. Getting individual one on one counseling from a certified professional can be your first step. If you are looking for a reputable credit counselor, the National Foundation for Credit Counseling (www.nfcc.org) has referrals to local and online credit counselors.

What to expect:

A credit counselor can sit down with your one on one to review your specific situation. A credit counselor may work with your creditors to reduce your payments or lower your interest rates as well.

Credit counseling should be explored if you are feeling the stress of overwhelming debt, or if you are facing bankruptcy or foreclosure.

CAUTION: Credit Counseling is not the same as a Credit Repair provider. Credit Repair providers do not offer anything that you cannot do for yourself in repairing your credit. Credit Repair providers can actually hurt your credit by delaying payments while negotiating a lower pay off for the debt you owe.

Minimum Payments

Card Balance	Interest Rate	Minimum Payment	Total Payment	Total Interest	Payment Time
\$5,000	15%	\$150	\$6,508	<u>\$1,508</u>	3 years 8 months
\$5,000	25%	\$150	\$8,625	<u>\$3,625</u>	4 years 10 months

It is easy to give into our desire for immediate gratification and buy items when we don't have ready funds. This can lead us to a growing credit card balance. Credit card companies can lull us into a sense of security by giving us a minimum monthly payment. This monthly payment stretches out the debt to the maximum period of time and keeps us paying interest for an item perhaps for years.

In this example, we look at the impact of minimum monthly payments using two different interest rates. Let's just take a look:

Both cards have the same balance (\$5,000). The minimum payment on the card is the same, but look at the amount of interest and the amount of time it takes to pay that debt. In the case of the 15% card, the total interest paid is \$1,508 or 30% of the total purchase. While the item might have been on sale at the time of purchase, by the time you are done with payments, you could actually have paid more than the full retail price.

The second card has the same balance, but a higher interest rate. In 4 years and 10 months of payments (assuming no other purchases are made in that time) you will have paid a total of \$8,625 for that \$5,000 item or 72% more than the original price.

Don't let a salesman or a credit card fool you into thinking that payments are affordable solutions when you are low on funds!

Paying Off Debt

Debt elimination involves three steps:

1. Stop acquiring new debt. This may seem self-evident, but it is very difficult to pay down your debts when you are continuing to add to your balances. This is the reason that we spent so much time in our lessons on money management. The purchases we make day by day will impact how much new debt is needed and our ability to pay down old debts.

2. Establish savings. Why save *before* paying off debt? Because if you don't save first, you're not going to be able to cope with unexpected expenses. Life happens ~ the car needs new tires, your hot water heater breaks ~ these are the things that drive up debt. If we have savings, though, we become our own lender. How much you need in savings will depend on your personal situation. Families need more in savings than singles and couples. A minimum is \$300, but saving \$1,000 is a nice, safe cushion. This will not happen over night, but every dollar helps establish this safety net. Remember, this is your savings. It's not to be used to buy shoes or go out for a meal with your friends. You'll want to keep the money where you can access it, but don't make it too readily available, especially if you'll be tempted to spend it on non-essentials. Consider opening a second savings account. When an emergency arises, you can easily transfer the money to your regular checking account. It'll be there when you need it, but you won't be able to spend it spontaneously.

3. Implement a debt snowball. After you've established some savings, tackle your debt. A debt snowball is a way of accelerating your way out of debt. We all want to get out of debt faster, this is a way of speeding up the process. With a debt snowball, you will pay off the first debt in full, then apply that payment to the next debt, so that you double your payments. After the second debt pays off, you apply both the first and second payments to the third debt. The easiest way to pay down debt is with a debt snowball. To create a debt snowball you:

- List all debts from the smallest balance to largest. Now, mathematically, it makes more sense to list debts based on interest rates and put the highest interest rate at the top. There's nothing wrong with doing it that way, and a lot of people do. By tackling the smallest balance first, though, you will start to **see results** faster and that will keep you motivated.
- Pay the minimum on everything but the smallest debt.
- Pay as much as you can on the smallest debt!
 - When the smallest debt is paid, take the monthly payment you were making on that debt and add it to the monthly payment you were making on the second smallest debt.
- Continue this process until you are DEBT FREE!!!

Debt Snowball

www.powerpay.org

Powerpay is a free website that allows you to enter your debts, and see how long it will take to pay off your debt using your current payment plan and then, see how quickly you will get out of debt using a snowball. A debt snowball does not require that you pay an additional amount monthly. It is a practice of paying off a debt and applying that payment as an additional payment on the next debt. But, if you have additional payments you can contribute, you get out of debt even faster.

Powerpay is available at their website www.powerpay.org or as an app for your Apple device.

Here is an example:

John has a little less than \$10,000 of debt. He has two credit cards, a vehicle loan and a student loan. He currently pays the minimum amount on each debt for a total of \$59.41 each month. Since he has been in Bank On he has developed a good monthly spending plan and has learned if he is wise with his monthly spending, he can pay an additional \$100 each month on his debt.

He goes to www.powerpay.org and enters in each debt and the website calculates his payment schedule for him.

Creditor Name	Balance	Minimum Payment	Interest Rate
Credit Card #1	\$ 432.97	\$ 25.00	23.75%
Credit Card #2	\$1,183.00	\$100.00	15.27%
Vehicle Loan	\$3,812.00	\$361.00	7.87%
Student Loan	\$4,418.18	\$105.41	6.18%
TOTAL	\$9,846.15	\$591.41	



Debt Snowball (Cont'd)

Month	CREDIT CARD 1	CREDIT CARD 2	VEHICLE	STUDENT LOAN
Aug 2018	\$125.00	\$100.00	\$361.00	\$105.41
Sep 2018	\$125.00	\$100.00	\$361.00	\$105.41
Oct 2018	\$125.00	\$100.00	\$361.00	\$105.41
Nov 2018	\$78.23	\$146.77	\$361.00	\$105.41
Dec 2018		\$225.00	\$361.00	\$105.41
Jan 2019		\$225.00	\$361.00	\$105.41
Feb 2019		\$225.00	\$361.00	\$105.41
Mar 2019		\$138.56	\$447.44	\$105.41
Apr 2019			\$586.00	\$105.41
May 2019			\$398.04	\$293.37
Jun 2019				\$691.41
Jul 2019				\$691.41
Aug 2019				\$691.41
Sep 2019				\$691.41
Oct 2019				\$670.86
TOTALS	\$453.23	\$1260.33	\$3958.48	\$4678.56

See how John is now paying the regular payment on every debt but one. The extra payment targets that high interest credit card that he had. Instead of paying that minimum payment of \$25, he now pays \$125.

Look what happens once John pays off his credit card in November... Any additional amount now gets moved to the next high interest credit card and he gets out of debt much faster. Then after the second debt is paid the extra is applied to the car loan.

NOTICE: John made a commitment not to build new credit balances. He did this by adjusting his current monthly spending to live on less than what he made and he avoids giving into his temptations to go out with friends. Instead, he has friends over to socialize at his apartment.

- Once John is out of debt, he can apply this payment to become a power saver (you can learn about power saving on the same website). Imagine how quickly he could save for his goals or even replace his car if he can avoid increasing credit balances and tucks that money aside for the future!

Debt Snowball (Cont'd)

	Without Snowball	With Snowball
Payment	\$591.41	\$691.41
Total Repaid	\$10,779.14	\$10,350.60
Total Interest	\$932.99	\$504.45
Time in Debt	4 years 0 months	1 year 3 months
Time Saved	2 years 9 months	
\$\$ Saved	\$428.54	

Powerpay will give you a payment plan like the one we saw on the last slide and will show you information about the money you save and how quickly you can get out of debt. What's more, you can play with the inputs at the website to explore how much you can accelerate your way out of debt.

For John, in the example we presented, Powerpay helped him save a total of \$428.54 in interest and instead of being in debt for 4 years, he is debt free in 1 year, 3 months. How encouraged would he be to see that he could get results like this? Powerpay can help you build your debt reduction plan and say goodbye to debt.

Review

Alright, we have covered a lot in this lesson. Let's just recap some of the key concepts.

Limit debt by developing a spending plan: By focusing on our monthly spending we can reduce our reliance on debt and begin the process of becoming debt free. We can limit the debt that we incur by evaluating our spending decisions and determine if the item we desire is a need or a want. We don't have to eliminate all the wants in our life, but we can choose not to use credit cards to get them.

Use traditional financing and avoid predatory loans: When you do need to finance a purchase, traditional financial institutions are almost always less costly than storefront lending. We also talked about different types of predatory lending products and the costs associated with them. Some people can get trapped in loans they can't afford to repay and working with lenders who don't even report your payments.

Debt consolidation: We talked about the pro's and con's of debt consolidation. It is certainly a better option than not paying your debts or filing for bankruptcy, but you will want to make sure that you have addressed the patterns of spending that caused that debt in the first place or you could be worse off after consolidating.

Build a debt snowball: Finally, we talked about accelerating your way out of debt by building a debt reduction plan or a debt snowball. We showed you how Powerpay can accelerate your way out of debt and save you interest you would have paid. By reducing your reliance on debt and eliminating the impact of debt on your monthly choices, you make more money available for savings to reach your future goals and to experience financial freedom.

Post-Test

1. What should you evaluate when considering a loan? (Select all that apply).

- a. Is there a less expensive alternative to this lender?
- b. What happens if my payments are late?
- c. What happens if the loan is not paid back in full?
- d. What are the fees and the APR

2. What actions can you take to reduce reliance on credit cards? (Select all that apply)

- a. Give into temptation
- b. Build savings
- c. Build a monthly spending plan
- d. Evaluate your needs and wants

3. Which of the following will NOT contribute to a successful debt snowball plan?

- a. Use a spending plan with expenses less than income to avoid new debt
- b. Pay the minimum on every debt except the target until it is paid off
- c. Not having a monthly spending plan
- d. Once a debt is paid off add those payments to the next target debt

4. Which of the following are true about a secured credit card? (Select all that apply).

- a. Uses your savings as collateral
- b. Requires a high credit score to qualify
- c. Helps you build your credit score
- d. Available to almost anyone, regardless of your credit history

5. What is true about predatory lending? (Select all that apply)

- a. The lender approves a loan based on your credit score
- b. The lender reports payments to credit reporting agencies
- c. The company is deceptive in its advertising
- d. APRs are less than traditional lenders

Glossary

- **2-1-1:** Non-profit referral service connects citizens with available assistance in the community.
- **Annual Percentage Rate (APR):** The cost of your loan expressed as a yearly percentage rate.
- **Buy Here/Pay Here:** A vendor that offers financing onsite, often not considering credit score.
- **Car Title Loan:** Also known as title loan, is a loan where the borrower provides their car title as collateral for a loan.
- **Cash Advance:** A loan from a credit card where borrower receives cash instead of purchasing products or services.
- **Debt Consolidation:** A method of refinancing debt to combine multiple debts or to extend the term of the loan to make payments more affordable.
- **Debt Snowball:** an accelerated debt repayment strategy in which applies payments for repaid debts to remaining debts.
- **Fees:** Money charged by a lender as one time cost or as a result of a penalty.
- **Interest:** Money charged by a financial institution based on the size of the loan paid in installments.
- **Payday Loan:** a small short-term loan. The loan service takes repayment in full within two paydays.
- **Pawn Loan:** Loan uses collateral of a personal item of value. If loan is not repaid, the collateral is forfeited.
- **Penalty:** a charge for activity outside scope of loan contract such as timely payment.
- **Prepayment Penalty:** a loan that charges an additional fee if you repay before the payment schedule is fulfilled.
- **Rent to Own:** a type of contract for tangible property, such as furniture, appliances or electronics is leased in exchange for a weekly or monthly payment with the option to purchase at some point.
- **Repossession:** lender takes back the collateral for a loan or leased property.
- **Tax Refund Anticipation Loans (RAL):** short-term cash advance against a customer's anticipated income tax refund.