



Planned Borrowing

Chapter 7



Debt payments/disposable income

| | |
|---------------|----------------|
| ■ 10% or less | Safe |
| ■ 11-15% | Possibly safe |
| ■ 16-20% | Fully extended |
| ■ 21-26% | Overextended |
| ■ 26% or more | Disastrous |



Debt payments/disposable income

- Disposable income is the amount you take home after all deductions are withheld
- Increasing debt payments from \$180 to \$450 has a dramatic effect on a budget
- All other categories may be affected by an increase in debt payments

Debt-to-equity method

- Debt of \$14,000 compared to \$42,000 in assets has equity of \$28,000 ($42 - 14$)
 $14,000 / 28,000$
- So the final amount is .50. A ratio in excess of .33 is considered dangerous

Continuous debt method

- If you are unable to get completely out of debt every four years, you rely on debt too heavily

Setting debt limits for dual-income

- If one person is no longer contributing (or contributing as fully), what was reasonable may no longer be reasonable

Language of consumer loans

- Cash loan vs. purchase loan
- Installment loans = repaid in a single payment (closed-ended) requires that the consumer repay the amount owed in a specific number of fixed loans
- Installment has a fixed interest rate
- Installment loans is the math we have been doing

Secured or unsecured loans

- Secured loans require a cosigner or collateral
- Security interest—the lender records a lien in the county courthouse
- Lien—legal right to seize and dispose of property in order to obtain payment of a claim

Secured loans

- Exercising the lien is known as repossession
- Acceleration clause stating that after a certain number of payments are missed (often times just one), the loan is considered in default and all remaining installments are due and payable upon demand



Unsecured loan

- Given on the good character of the borrower
- Signature loans—because the only thing that backs them up is a signature



Purchase loan installment contracts

- Installment purchase agreements in which the title of the property passes to the buyer when the contract is signed
- Conditional sales contracts (financing leases) in which the title does not pass to the buyer until the last payment is made



Prepayment policies

- Special charge to the borrower for paying off a loan earlier than the final due date

Variable rate loan

- A periodic rate that fluctuates according to some measure of interest rates in the marketplace
- For example, 5% plus the prime rate
- Final balloon payment (abnormally large compared to the other installment payments)

Effect of using voluntary repossession

- Deficiency balance—is a sum of money owed after collateral or repossessed property is sold and the proceeds of the sale, less the expenses (collection, attorney, and court costs) involved in the repossession
- Even after it is repossessed, you may still owe money

The impact of divorce

- Jointly held accounts are the responsibility of EITHER party
- Get credit reports
- Close joint accounts

Sources of consumer loans

- Depository institutions
 - Prefer to make loans to good risks
- Consumer finance companies
 - Small loan company, higher rates, smaller loans
- Sales finance companies
 - A business-related lender

Source of consumer loans

- Loans from investment accounts
 - Borrow from investments they have built up over the years
- Life insurance companies
 - Cash-value life insurance policies can obtain loans from their life insurance (takes a LONG time to build up cash value)

Alternative lenders

- Pawnshops—lender that offers single payment loans (\$100-500)
- Pawnshops can sell the item if it is not reclaimed in a month or two
- Only loans cash equal to one third or less of the value of the property



Alternative lenders

- Rent-to-own little or no down payment
- The renter does not own the item until the final payment is made
- Failure to meet a payment means the property will be seized
- Interest rates are astronomical (for example, a \$300 TV will cost you \$780)



Check cashers

- Businesses that cash checks for people who do not have bank accounts
- They agree not to deposit personal checks until a certain time in the future
- Charges range around 20% of the check



Rapid refund taxes

- Some fill out tax forms, some just verify the tax form and the amount of refund due
- The borrower signs over the tax refund to the company
- APRs for these loans are very high—25 to 75% relative to more traditional lenders



What it costs to borrow money

- Note huge variations in the chart



Friends and relatives

- Friends and relatives may use a promissory note



Calculating finance charges

- Simple interest method, add-on method, discount method (you are responsible for knowing how to use a chart)



Signs of overindebtedness

- Exceeding debt limits and credit limits
- Running out of money
- Paying only the minimum amount due
- Requesting new credit cards and increases in limits
- Paying late or skipping credit payments
- Not knowing how much you owe



Signs of overindebtedness

- Taking on add-on loans
- Using debt consolidation loans
- Receiving notice of repossession or foreclosure
- Experiencing garnishment



Federal law regulates debt collection

- Debt collection agencies are firms that specialize in making collections
- Not allowed to deceive you, make threats, or use abusive language

Bankruptcy as a last resort

- Chapter 13 regular incomes and secured debts up to \$750,000 and unsecured debts up to \$250,000
- Court notifies creditors of petition for bankruptcy and there is a hearing
- Court-approved plan of making payments

Bankruptcy

- Chapter 7 is used when it would be highly unlikely that substantial payment will ever be made
- Some debts are never excused such as education loans, alimony, child support, income taxes, debts not listed, punitive damages

Manage if you become overindebted

- Determine what you owe
- Focus on debt reduction
- Contact your creditors
- Take on no new credit
- Refinance
- Find good help and avoid bad help
