

Loans

S.K.Y. Youth Account Education Program

Loans

- “Loans” are borrowing money under a contract
- Someone fronts you the money to *make a purchase now* and you **pay it back over time**
- It's **not free money**- credit has a cost

How Loans Work: #1

The higher the interest rate, the more you pay!

- Interest rates are expressed as an Annual Percentage Rate (**APR**)
- The higher the APR, the bigger the chunk of money they are charging you

How Loans Work: #2

Interest is added to your loan balance *every single day* (This is called “**compounding**”)

- APR is an *annual* rate
- To figure out how much is *added daily* use the following steps...

Calculating Interest

Assuming a \$1,000 loan with a 10% APR:

A) $0.10/365 = 0.000274$ (*Daily Periodic Rate*)

B) $\$1,000 \times 0.000274 = \0.274 (Added daily)

C) $\$0.274 \times 25 \text{ days} = \6.85 (Interest added total)

D) So a payment of \$50 covers \$6.85 in interest and \$43.15 of the principal. **New balance = \$956.85**

How Loans Work: #3

The longer your “loan term” (how long it takes to pay it back) the *more you pay*

- Longer loan terms have lower monthly payments, but you'll end up paying significantly **more money**

How Loans Work:

- The total amount you pay is proportional to the term and interest rate

Amount Borrowed	Annual % Rate	Term	Monthly Payment	Total Interest Paid
\$1,000.00	15.00%	12 months	\$90.26	\$83.00
\$1,000.00	15.00%	36 months	\$35.00	\$248.00
\$1,000.00	5.00%	36 months	\$29.97	\$79.00

How Loans Work: #4

The higher the “**risk**” (how likely they are to lose money) the higher the rate will be

- **Secured loans** = lower lender risk (Ex: car loans, home loans, etc.)

- **Unsecured loans** = higher risk (Ex: credit cards, personal lines of credit, etc.)

How Loans Work: #5

The more you borrow, the more you pay

- Mortgage loans are typically paid over 30 years—that's 360 payments!
- If you borrowed \$200,000 at 6.00% APR, you would pay **\$231,676 in total interest** over 30 years (in addition to the amount you borrowed)

Fact #1

- The higher the rate of interest, the more the loan will cost you:
 - One month of interest on a \$1,000 balance at 10% is \$10.00
 - The same balance with a 25% interest rate is \$25.00 in fees

Fact #2

- The longer your loan term the more you pay:
 - The more time your balance spends collecting interest, the more interest you will pay
 - Taking out a \$10,000 loan for 4 years vs/ 5 years at 7.5% is a difference of \$400.00

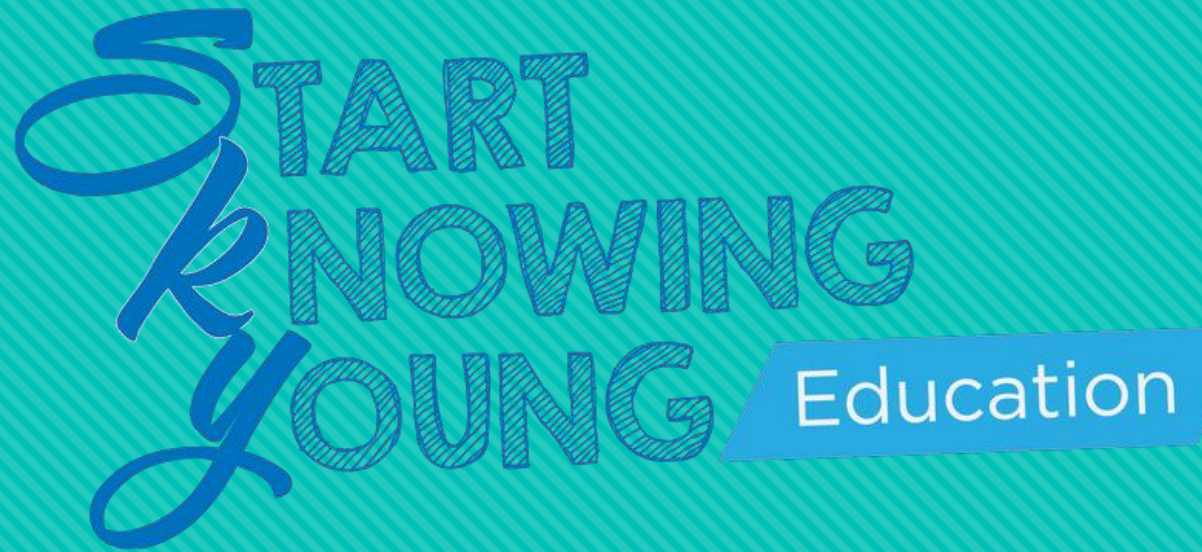
Fact #3

- Interest is added to your loan balance **every single day**:
 - Most credit card companies compound interest daily, which means each day's interest is added on to your principal
 - Although daily its probably just a few cents being added on, the extra interest adds up over time

Fact #4

- The more you borrow the more you pay:
 - The higher balance you have, the more interest you pay
 - Direct proportion between amount borrowed and amount paid

Thank You!



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