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 x 0.000274 = $0.274 (Added daily)

C) $0.274 x 25 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 <u>longer your "loan term"</u> (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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