



## Part 4: Borrowing Money and Using Credit





# Borrowing Money

Let's discuss...

- 💰 Why people borrow more money today than in the past
- 💰 Why people borrow money
- 💰 Types of debt/credit
- 💰 The cost of borrowing

Most Canadians will have to borrow money at some point in their lives. It may be using a credit card to borrow money for a short time (hopefully a short period!). It may be a mortgage for a house that may take 25 years to repay. Borrowing money, and using debt, does not have to be a bad thing. It can help you in times of need or trouble – help you with large purchases – help you manage your monthly cash flow (consolidation loan) – and so on.



WHAT IS YOUR ATTITUDE TOWARDS BORROWING MONEY? THERE IS AN OLD SAYING "NEVER A BORROWER OR LENDER BE." SOME PEOPLE WORK TO AVOID DEBT. SOME TAKE ON WAY TOO MUCH. WHERE DO YOU FALL?

Debt  
Avoider

Use when  
needed

Too much  
debt

1

2

3

4

5

Borrowing money becomes a problem if you borrow too much – that is, more than you can afford. It's a problem if you borrow to where you can't do other things – or if you need to borrow to pay your regular monthly expenses. Just like your own money, you have to stay in control of the money you borrow from others.

Let's begin by covering a few terms.

A *debtor* is someone who borrows money from others. A *creditor* is someone who lends money to others. A *debt* is a *liability* – something that you owe. A *credit* is an *asset* – it is money that has been loaned to someone else to be paid back.





OVER TIME, YOU WILL LIKELY ACQUIRE "ASSETS" AND TAKE ON "LIABILITIES." YOUR "NET WORTH" IS ONE WAY TO TRACK HOW YOU ARE DOING, FINANCIALLY, OVER TIME. YOUR NET WORTH IS "YOUR ASSETS (WHAT YOU OWN) – YOUR LIABILITIES (WHAT YOU OWE.)"

Borrowing money can be done in a number of ways. We will look at ways to borrow money in a moment. For now, let's look at why people are borrowing more money today than in the past.

## Borrowing Money Today

Today, in general, more people are borrowing money than people did 30 or 40 years ago. Why is that?

One reason people borrow more money today is that, by and large, incomes are higher than they used to be. With higher incomes, people can often afford to carry more debt. For example, if you earn an income of \$80,000 a year and want to borrow \$3,000 for three years, you probably won't have much of a problem (if you have a good "credit rating" and are seen as "credit worthy" – more on that shortly.) Why? Because your income is such that you probably won't have trouble paying back what you borrowed.



IF YOU HAVE A CHANCE, TALK WITH A PARENT/GUARDIAN/FAMILY MEMBER, ETC. ABOUT HOW THEIR PARENTS VIEWED AND USED DEBT. DIFFERENT FROM TODAY?



THE AMOUNT YOU BORROW IS CALLED THE "PRINCIPAL." THE COST YOU PAY FOR USING SOMEONE ELSE'S MONEY IS CALLED "INTEREST." WHEN YOU TAKE OUT A LOAN, YOU WILL HAVE TO PAY BACK BOTH THE PRINCIPAL AND INTEREST.

However, if you have an income of \$10,000 a year, you might be less willing, and less able, to borrow \$3,000. You will have a lower "ability to pay" or "ability to carry the debt." People often refer to money that is borrowed as "carrying a debt" or a "debt load." That is because debt is usually seen as a financial burden.

A person's ability to pay and "carry debt" will change, then, with their income. As your income rises, you may be able to afford more debt. You certainly don't have to borrow more. Just because you may earn more, think carefully before taking on more debt.

Another reason for more borrowing today is due to higher prices. As prices rise, the need to borrow may increase – especially if prices rise at rates faster than incomes. Housing is an example. House prices have, on average, risen over the years to the point where very few people can buy a house today without taking on a mortgage – often quite a sizeable mortgage. A mortgage is a loan taken out to buy a house or other property. More people likely have bigger mortgages today than was the case 30–40 years ago because the cost of housing is now so high.



THE AVERAGE COST OF A HOUSE IN CANADA AS OF JULY 2012 WAS \$353,147. CHECK OUT THE COST OF HOUSES IN YOUR AREA BY LOOKING AT THE REAL ESTATE SECTION OF THE PAPER OR BY SEARCHING ONLINE (CANADIAN REAL ESTATE ASSOCIATION AT: WWW.CREA.CA). WHAT LEVEL OF INCOME DO YOU THINK YOU MIGHT NEED TO BE ABLE TO AFFORD A HOUSE IN YOUR AREA? WHAT ARE THE OPTIONS TO BUYING A HOUSE? WHAT WOULD THE OPTIONS COST? WHAT LEVEL OF INCOME WOULD YOU NEED TO AFFORD ONE OF THE OPTIONS?

Another reason people are borrowing more today is because, overall, people are spending more of their income – and saving less. Back in the early 1980s, Canadians, on average, were saving over 20% of their income. In recent times, the average has fallen, at times, to 0. That is, overall, Canadians were spending as much as was earned in income. Recently, the savings rate has risen to about 4% – but that is still pretty low. The result – without much in savings, Canadians are finding they have to take on more debt to cover expenses as they come up. So borrowing increases.

That brings us to another reason why there is more borrowing today – the cost of borrowing has been so low. Like it is for other things, if the cost to borrow money goes down, people will probably borrow more of it. And that is what people have done – borrowed more as the cost of borrowing – interest rates – fell.



WHY DO YOU THINK CANADIANS ARE SPENDING SO MUCH OF THEIR INCOME AND SAVING SO LITTLE?

There is little doubt that, overall, Canadians have likely borrowed too much. Many people are under financial stress. Many live paycheque to paycheque and many would be in difficulty if they lost their job, got ill, or had an unexpected expense arise. People such as the Governor of the Bank of Canada have spoken about the concern that Canadian “household debt” is too high. Why? If Canadians struggle with debt as many do, what happens when the cost of that debt (interest rates) rises? Any struggle Canadians have carrying debt will be harder when the cost of debt goes up.



The average level of household debt in Canada – not counting mortgage debt – has been in the range of \$25,000 in recent years. Many Canadians took on debt without really knowing how much they could afford – and didn’t plan for interest rates rising. Know how much debt you can afford. Don’t borrow to your limit. And be prepared as the cost of your debt can rise if interest rates should rise.

That is why there is such concern when Canadians spend most of their income, save so little, and borrow a lot. Too many may be stretched and struggle with debt they have. When interest rates rise that is when things could get really difficult.

So low interest rates have led to more borrowing too. Another reason for more borrowing is because more people are borrowing to make investments. In some cases, tax changes have encouraged people to borrow for investment purposes. For example, a person may be able to get a tax deduction on certain investments such as a contribution to a Registered Retirement Savings Plan (RRSP.) Also, income earned from investing may be taxed at a lower rate than income you earn from working at a job. For example, the tax rate on “dividends” is lower than on employment income. Dividends are the shares of a company’s profits that are given to shareholders. The lower rate of taxes on dividends has been to try and encourage people to invest in businesses to help them grow, improve, and help create more jobs.

For these and other reasons there is more borrowing today by more people than in the past. As a result, there are also more people having debt problems. Most adult Canadians didn’t learn much – if anything at all – about borrowing money and managing debt while in school or from their parents. Many people have given in to the temptation to borrow more...and more...and more. And many are now stretched to their limit – and beyond.



### Take action. Take control!

If you can, and if you wish, ask at home about what has been learned about borrowing money and managing debt. Did people in your family get a good education about borrowing money and managing debt? Do they have insights, advice, and guidance that they can share with you based on what they learned – or their experience?

One of our goals is to try and change that. We hope today’s young people can learn more about money – and borrowing – and managing debt – and make good borrowing decisions. Borrowing money doesn’t have to be a bad thing. It can help. Borrowing just has to be done wisely, managed well, and held to a limit you can afford.

So these are some of the reasons why borrowing has increased – and why more people are “over their heads” in debt. We want to help you avoid that. Let’s take a closer look at why you may decide to borrow money.

## Why Borrow Money?

- **Unexpected expenditures:** Maybe your car has broken down – or your air conditioner dies during the hottest days of the year. It is important to try and save to be prepared for these unpleasant surprises. But, if they happen, and you don't have the funds available, borrowing money may be an option.
- **Education and training:** This is actually another type of investment – an investment in the improvement of a person's knowledge and skills. You can look upon it simply as an investment in you.



HAVE YOU HAD ANY SURPRISES TO DATE IN YOUR LIFE – EXPENSES COME UP THAT YOU DID NOT FORESEE? IF SO, HOW DID YOU HANDLE THOSE?

People will often borrow to improve their education and training because this can help them to get the job or career they want – or to get a better paying job. The benefits of this kind of investment can last a lifetime. But, if you borrow money for education or training, make it a good decision. You don't want to find you are \$25,000 in debt after university and feel that you are not where you hoped to be. Make wise choices about how you use borrowed money to invest in you.

- **The “big buys:”** Some items cost so much most people can't pay for them out of current income and savings – for example, cars, boats, houses, and cottages or cabins. To be able to buy them you will likely have to tap into your future income by borrowing money that will be paid back over time – sometimes many years with money you will make in the future.
- **Investments:** Some people borrow money to invest. They try to pick good investments to increase the value of that money in the future. People will do this if they believe they can earn more from the investment than it costs them to borrow. That is, they think the “rate of return” will be higher than the rate of interest to borrow. There is always risk in this kind of borrowing.
- **Opportunities:** Sometimes opportunities come up – opportunities too good to pass up. For example, suppose you love to play the piano and one of your goals is to get your own piano some day. Suppose you come across the deal of a lifetime – just the piano you want at a price better than you are likely to see again. You may decide that borrowing money is worth the cost of the debt to get something you've always wanted. Remember – an important part of managing money is to be happy. Having debt troubles won't make you happy. You will want to do all you can to avoid them. But, if the piano will help you with your “happiness” goal, and if you can afford the debt, that may be a good decision for you.



DO YOU KNOW PEOPLE WHO HAVE GONE INTO DEBT FOR 3-5 YEARS OF EDUCATION AND WHO WISH THEY HAD MADE A DIFFERENT DECISION? ARE YOU GETTING THE HELP AND GUIDANCE YOU NEED TO MAKE GOOD INVESTMENTS IN YOU? ARE YOU EXPLORING ALL YOUR OPTIONS? ARE YOU AWARE OF ALL YOUR OPTIONS?



## Take action. Take control!



If you can, start saving for your future education at a young age. Small amounts of saving can add up to quite a bit over time. And there are government programs that can help. Check out the Canada Savings Bond program and the Canada Education and Savings Grant. They can provide money to help you with your saving for education.



IS THERE ONE SPECIAL THING IN LIFE YOU ARE HOPING TO HAVE SOME DAY? HAVE YOU THOUGHT ABOUT HOW YOU MIGHT GET IT – OR THE TRADE-OFFS YOU MIGHT HAVE TO MAKE TO GET IT?

- **Rainy days:** Some day you may suddenly lose your job and find it necessary to borrow money to get through a difficult time. You or a family member may also become ill or disabled and not be able to earn an income for a while. Once again, borrowing money may help.
- **Start a business:** If you are, or hope to be, an entrepreneur, you may need to borrow money to help start up, launch, and run your business. Very few entrepreneurs are able to get started without getting some financial help. You may also need to borrow money to help the business grow if it is successful.
- **Travel:** There are some people for whom travel is very important. They may have a dream of taking a certain trip or travelling for a period of time. It is not uncommon today for some students to want to do some travel before moving on to post-secondary education or training – or before settling into a job. Such travel may require debt. Therefore, some people may be willing to borrow money, and give up some other things in the future, to be able to travel today.
- **Simplify purchases:** Carrying cash today is becoming less and less common. People seem to be carrying less money and using cards to simplify purchases. This may mean using a debit card – which takes money out of your bank account right away. Or it may mean using a credit card, borrowing money, and paying it back later. So some short-term borrowing by using credit cards can help with purchases.



ARE YOU A POSSIBLE ENTREPRENEUR? CHECK OUT THE SECTION ON ENTREPRENEURSHIP TO SEE IF YOU MAY BE A FUTURE ENTREPRENEUR.



ARE YOU PLANNING ANY EXTENSIVE TRAVEL IN THE YEARS AHEAD? IF SO, DO YOU HAVE THE MONEY TO PAY FOR IT? IF NOT, HOW ARE YOU GOING TO GET THE MONEY TO COVER THE EXPENSES?



These are some of the reasons why you may decide to borrow money. But, if you want to borrow money, who lends money – and why? Parents, other family members, and friends may lend you money to help you out. Be careful though, about borrowing from friends and family. You don't want "money issues" to affect your relationships.

For the most part, though, people borrow money from sources other than friends and family. These other sources will charge interest to you for the money you borrow (some friends and family members may too.) There will be a number of things that will affect the interest rate they charge. We will look at the "cost of credit" shortly. First, let's look at the different kinds of borrowing you can do.

## Types Of Debt/Credit

- **Credit cards:** An institution, such as a bank, may decide to provide you with a credit card. This card will usually have a "credit limit." This will be the maximum amount they are willing to lend you. You can then use the card to charge purchases up to that limit.
- **Charge accounts:** This is the term used to refer to cards that are like credit cards but, rather than getting them from an institution like a bank, you get them from a particular store – a retailer. You may, for example, have a "Bay card," a "Sears card," or a "Canadian Tire card." These cards are issued by the stores and companies to help, and encourage, you to buy their products. As with credit cards, know what the interest rate is, when interest is charged, what fees apply, and so on. Be careful that having a card like this stops you from comparing prices in other stores.

Each month you will receive a "statement." This will show the purchases you made using the card, interest that you have to pay on the money borrowed, and also interest you have to pay on any past purchases for which money is still owing – that is, any past "balance" you are carrying on the card.

Try, as best you can, to pay off your credit card balance each month. Interest on credit cards is very high (e.g. 28% in many cases.)

Some credit cards won't charge you any interest if you pay your bill in full each month. Some may charge interest from the date you buy something. If you have a credit card, see how yours works. You may also pay an annual fee for your credit card. See if such a fee applies to you. Also, pay your credit card bills on time. You can be charged "late payment fees," if you don't. Paying late also won't help if you want to borrow money. Lenders want to see that you pay your bills – and pay them on time.



DO YOU HAVE A CREDIT CARD? IF SO, ARE YOU ABLE TO PAY THE BALANCE EVERY MONTH? ARE YOU CARRYING ANY DEBTS ON YOUR CREDIT CARD THAT HAVE BEEN THERE FOR MORE THAN 3 MONTHS OR MORE? IF SO, LOOK AT THE INTEREST CHARGES YOU ARE PAYING.



As best as you can, pay your credit card bills in full each month. Don't put more on a credit card than you can afford to pay back. Don't leave balances on your credit cards. And know the "terms" of your credit card – what interest is charged – and when is it charged. Visit the web site of the Financial Consumer Agency of Canada (FCAC) for help with selecting the right kind of credit card for you.

- **Consumer loans:** Loans are available from various financial institutions for a wide range of consumer purposes – to buy a car, for travel, for house renovations, for a boat, for a computer. These loans tend to be for periods from months to about 5–7 years. When you take out a loan, you will arrange to pay it back over time. Try and pay back any loan as quickly as possible. You will pay less total interest the faster you pay back the loan.
- **Mortgage loans:** These are loans to help you purchase property such as a house. A mortgage loan tends to be over a longer period of time than consumer loans. Mortgage loans can generally be taken out for up to 25 years. That's because mortgage loans are usually for more money than consumer loans and people usually need more time to pay back the higher loan. More on mortgages shortly.
- **Business loans:** These are loans some people take out to help them start, improve, or expand a business. Financial institutions may lend money to businesses for a variety of reasons. The business will have to make the lender feel confident that the business will do well and be able to pay back the loan. Institutions will often want to see a good "business plan" or a good record of success before giving a business loan.
- **Installment buying:** It may be possible to make a purchase by paying in installments. For example, you may buy a washer and a dryer and agree to make a monthly payment for 12 months to pay for them. Generally, if you purchase something through installments, you will have to pay interest charges – but you do get use of your purchase while you are paying for it. You may arrange to do this to buy a computer, or a TV, or a refrigerator. You may also find some places that let you pay in installments without interest. You have likely heard ads offering "No money down! No interest! No payments for 24 months!" Some of these offers are very legitimate and are set up to help you make a purchase – and for the business to make a sale. But, before making such a deal, ask questions and check into the terms. Ask if there is any upfront administration fee or fee of any kind. Ask if there are any other fees or charges. And ask if there is any reason why interest charges might increase or be charged. If you buy something this way, don't miss a payment – and pay the final bill on time!



CHECK TO SEE IF ANYONE IN YOUR FAMILY HAS EVER MADE A PURCHASE THIS WAY. IF SO, WHAT WAS THE EXPERIENCE LIKE FOR THEM? DID IT WORK OUT WELL? DID IT WORK OUT NOT SO WELL?

These, then, are some of the various forms of credit, debt or loans you might get. Keep in mind, though, that most lenders lend money for one purpose – to earn interest. They will want to be repaid for sure. But they will want to increase the value of their money by earning interest. Let's look more closely at the cost of credit and things that can affect the interest rate you pay.

## The Cost Of Borrowing Money

The cost of credit is the amount of interest that is paid on the loan. But the total you will pay on a loan will be determined by more than the rate of interest.

The total cost will also be affected by how long it takes you to pay back a loan. The longer it takes you to pay back money you borrow, the more you will pay in interest. As an example, consider a mortgage loan. Look at the following three tables.

### \$60,000 Mortgage

#### 15-year Amortization (paid back over 15 years)

| Interest Rate | Monthly Payment | Total Repaid | Total Interest Payment |
|---------------|-----------------|--------------|------------------------|
| 4%            | \$443.81        | \$79,886     | \$19,886               |
| 6%            | \$506.31        | \$91,136     | \$31,137               |
| 8%            | \$573.39        | \$103,210    | \$43,210               |
| 10%           | \$644.76        | \$116,057    | \$56,057               |

#### 20-year Amortization

| Interest Rate | Monthly Payment | Total Repaid | Total Interest Payment |
|---------------|-----------------|--------------|------------------------|
| 4%            | \$363.59        | \$87,262     | \$27,261               |
| 6%            | \$429.86        | \$103,166    | \$43,166               |
| 8%            | \$501.86        | \$120,446    | \$60,447               |
| 10%           | \$579.01        | \$138,962    | \$78,963               |

#### 25-year Amortization

| Interest Rate | Monthly Payment | Total Repaid | Total Interest Payment |
|---------------|-----------------|--------------|------------------------|
| 4%            | \$316.70        | \$95,010     | \$35,011               |
| 6%            | \$386.58        | \$115,974    | \$55,974               |
| 8%            | \$463.09        | \$138,927    | \$78,927               |
| 10%           | \$545.22        | \$163,566    | \$103,566              |

Note that if \$60,000 is borrowed for 15 years at 4%, the total interest paid is \$19,886. If the interest rate is 8%, the total interest paid is \$43,210. That shows how important the interest rate is. But how about the time to pay back the loan?

Note that if \$60,000 is borrowed at 4% interest and paid back over 15 years, the total interest paid is \$19,886. If the \$60,000 is paid back over 20 years, the total interest payment is \$27,261. The same loan amount – \$60,000 – costs \$7,375 more if it is paid back over 20 years as opposed to 15 years. It is obvious that the amount of time you take to pay back a loan is very important.

The cost of the loan can also be affected by where you borrow the money. If you have a good borrowing history, you will probably be able to get a loan from a traditional lender such as a bank. However, if you do not have a good credit history, or if you are experiencing some money challenges, you may have to go to other sources where costs may be higher – in some cases, quite a bit higher. This is why you want to have a good “credit rating.” More on that later.



**THE HIGHEST INTEREST RATE THAT CAN LEGALLY BE CHARGED IN CANADA IS 60%. MOST REGULAR LOANS YOU GET FROM MOST LENDING INSTITUTIONS WON'T BE ANYWHERE CLOSE TO THAT. BUT MAKE SURE YOU KNOW THE INTEREST RATE YOU WILL BE PAYING ON ANY LOAN YOU TAKE OUT.**

Some people who need to borrow money use “payday loan” or “cheque cashing” companies. The costs at such places are higher than traditional institutions such as banks. Before using a “payday loan” company ask about the costs of borrowing money. Also ask what happens if you have trouble paying the money back. And ask what the “annual interest rate” is on any loan you consider. Be careful of getting into a situation where you have to take out a new loan to pay off an old loan.

In fact, whenever you consider taking out any loan (or using credit), ask what the interest rate is and how much total interest you will be paying. Good creditors will not hesitate to give you honest, accurate information. And get everything in writing.



**DO YOU KNOW PEOPLE WHO HAVE USED PAYDAY LOAN OR CHEQUE CASHING PLACES FOR LOANS? IF SO, WHAT HAS THEIR EXPERIENCE BEEN LIKE? DID THEY NEED TO USE SUCH FACILITIES FOR BORROWING OR DID THEY HAVE A CHOICE?**



Common lenders, such as banks, will often base their loan rates on something called the “prime rate” of interest. The prime rate is the rate of interest that the institutions charge to their largest, most reliable customers – often large corporations.

When you go into a bank or other institution to take out a loan, you will meet with a loans officer. He or she will discuss your situation with you, take down the details of your request, ask questions related to your credit worthiness (more on this in a moment), and so forth. The loans officer will also do a “credit check” – that is, a check on your credit rating. After that, if the institution is willing to lend you the money, you will learn the rate of interest that you would be charged for the loan if you take it. If you are a new borrower, you will not likely get a loan at the “prime rate.” You will likely be told that your rate will be something like “prime +3%” or “prime +2.5%” – meaning you will pay the prime rate plus that extra – e.g. prime +3 would equal 6% if the prime rate was 3%. The better your credit rating, usually the lower rate you get since the lender’s risk is lower.



**GO ONLINE AND VISIT SOME SITES TO LEARN MORE ABOUT WHAT IS INVOLVED IN A LOAN APPLICATION. CHECK OUT THE SITES OF SOME OF THE BANKS AND THE FINANCIAL CONSUMER AGENCY OF CANADA TO SEE WHAT A “LOAN APPLICATION FORM” LOOKS LIKE AND THE KIND OF INFORMATION THAT YOU WILL BE ASKED TO PROVIDE IF YOU APPLY FOR A LOAN.**

Don’t borrow from the first place you visit unless you have some special reason to do so. It may be that your family has banked at a particular bank for years and has a good reputation there. You may want to bank there as well – or find it easier to do so because the family is well known there and has a good history with the bank. But if there is no particular reason to pick one over another, don’t hesitate to compare institutions and their interest rates. Financial institutions do compete with one another. There is a chance that another institution may offer you a loan at a lower rate of interest. Financial institutions will also often be prepared to match rates offered to you by other institutions – if you ask them.



**HAVE PEOPLE IN YOUR FAMILY TRADITIONALLY DONE THEIR BANKING AT A PARTICULAR BANK? IF SO, YOU MAY WISH TO ASK WHY? SEE IF THE FAMILY IS HAPPY WITH THAT BANK – OR WHY THEY MAY THINK YOU SHOULD EXPLORE YOUR OPTIONS FOR BANKING.**

Another important point to note about loans is the down payment. This refers to the amount of money you can pay at the time of purchase versus how much you have to pay through borrowing. For example, suppose you are going to spend \$8,000 on a car and you have \$3,000 available. You can use the \$3,000 as a down payment and borrow the remainder. (Borrowing is often referred to as “financing” – you put down \$3,000 and “finance” \$5,000.)

Therefore, the total cost for the car will be \$8,000 plus whatever interest you have to pay on the borrowed money (that is, interest on the \$5,000). The key point is that the higher your down payment on any purchased item, the less you will have to borrow (finance) and the less your total interest cost will be.



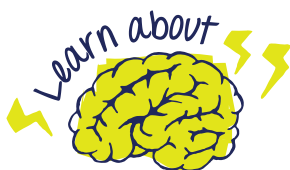
## WHAT CAN AFFECT YOUR COST OF BORROWING?

Compare:

1. The difference between paying 3% for a \$2,000 loan over two years versus paying 5% for the same loan for two years.
2. The difference between paying off a \$3,000 loan at an interest rate of 7% over two years versus paying off the same loan over four years.
3. The difference in total cost for a \$4,000 car (a) with a \$2,000 down payment and financing \$2,000 over three years at 4% versus (b) financing the entire \$4,000 over four years at 8%.

So, let's summarize some of the key points we have covered about borrowing money:

- Know the total cost you will pay for any loan you take on – principal + interest costs.
- Pay off credit cards each month. Don't carry debt on credit cards. If you can't pay off what you owe on a credit card, and you have been carrying a growing balance on your card, consider taking out a regular loan to pay off the credit card balance. You will pay a lot less in interest on a regular loan than you will on a credit card debt.
- Comparison shop for the best interest rate you can get.
- Decide on how much time you will need to pay back money you borrow. The shortest time you can afford will be the best since it will reduce your borrowing costs.
- Put down as large an amount (down payment) as you can to lower the amount you will have to borrow. This will lower the interest you will have to pay, and, hence, the total cost to you.
- Lenders lend money to earn interest. They will want to have confidence that you will pay the money back – and be able to afford the interest. That is why they will usually do a "credit check" on you. Make sure you pay back loans and make payments on time so that you have a good credit record.
- There are a variety of reasons why you may want to borrow money – and a variety of factors that will affect whether others – will lend you money. There are also a variety of factors that will affect the interest rate you may pay on a loan.
- There are different ways to borrow money – and the costs can differ from one way to another.



## COMPARISON SHOPPING FOR INTEREST RATES

Suppose you want to buy a brand new car for \$24,000 and you are going to finance \$22,000. Explore the different rates offered by lenders on car loans and see what your total cost would be, at different rates of interest, to pay back the loan over 5 years.



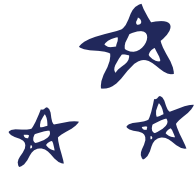
SUPPOSE YOU ARE A CREDITOR WITH MONEY AVAILABLE TO LEND. SOMEONE COMES TO YOU WHO WANTS TO BUY A BOAT FOR \$22,000 AND BORROW \$18,000 FROM YOU TO DO IT. WHAT INFORMATION WOULD YOU WANT TO KNOW PRIOR TO DECIDING WHETHER OR NOT TO PROVIDE THE LOAN?

Probably the most important thing about borrowing money is to ask questions to get the information you need to make a good decision. You have a right to know what you need to know to make a good borrowing decision. You will also likely earn respect from lenders who will be pleased to see how thorough you are as you make your decision. It will be a sign that you will likely be responsible about paying the money back.

The following are some questions you should be sure to ask when taking out a loan.

- What is the interest rate on the loan? Is it possible to have a lower interest rate? What would be needed to lower the rate?
- Is the interest rate on the loan fixed or does it vary?
- What are the first and last payment dates? Are there any penalties for late payments?
- Can I pay off the loan at any time? If so, is there any penalty for doing so?
- Are there fees other than interest payments?
- How frequently will interest on my loan be calculated?
- What happens, or what can be done, if I miss a payment or am unable to make one for any reason?
- Are there any other factors that may affect the total cost of the loan?
- Are there ways that I might be able to lower the total cost of the loan?

There are other questions that you may have. Don't be afraid to ask! Decisions about borrowing money are important decisions. You want to make sure you are making a good decision. Asking questions, and getting the information you think you need, is part of making a good borrowing decision.



## Chapter Summary

### Say What? Possible New Terms!

1. **Debtor:** is someone who borrows money from others.
2. **Creditor:** is someone who lends money to others.
3. **Liability:** is something that you owe.
4. **Asset:** is something you own that has value.
5. **Net worth:** your assets (what you own) minus your liabilities (what you owe.)
6. **Principal:** the amount of money borrowed that has to be repaid. It does not include any interest charges that have to be paid for borrowing money.
7. **Dividend:** the shares of a company's profits that are given to shareholders.
8. **Amortization:** the period of time over which you agree to pay back a loan — such as a mortgage — via a series of regular payments.

### Did It Stick? Can you recall ...?

1. What are some of the reasons why people tend to borrow more money today than 30–40 years ago?
2. What are some of the reasons why people borrow money?
3. What types of debt or credit can people use to borrow money?
4. What are the major factors that can affect the cost of borrowing money?
5. What can you do to try and keep your costs of borrowing money as low as possible?

### Thinkabout ... or discuss:

- 💰 What do young people spend most of their money on? Why?
- 💰 Are most young people today in control of their money? What are some of the causes of young people losing control of their money?
- 💰 Do young people have too easy access to credit cards? Or are credit cards almost a necessity today?
- 💰 Do you know others who are having money troubles — or who you think are headed to money trouble? If so, what's causing this?

### Tips and Suggestions

- 💰 Know what debt you can afford and don't borrow more than you can afford.
- 💰 Shop and compare costs when borrowing money.
- 💰 Know the total cost of any debt before borrowing money — and find out if the total cost can change for any reason.
- 💰 At different points in your life, check your “net worth” to see if you are making financial progress.
- 💰 Avoid borrowing to your “credit limit.” Borrow what you need to borrow — not what you can borrow.
- 💰 Avoid having multiple credit cards. Stick to one or two. Having debts on many cards can lead to debt troubles.
- 💰 Don't carry balances on credit cards. And pay off credit card debts each month — in full — and on time — if you can.

### Tech-Talk

Some web sites that you might find useful would be:

- 💰 Credit Canada — Debt Solutions: [www.creditcanada.com](http://www.creditcanada.com)
- 💰 Financial Consumer Agency of Canada: [www.fcac-acfc-gc.ca](http://www.fcac-acfc-gc.ca)
- 💰 Fiscal Agents: [www.fiscalagents.com](http://www.fiscalagents.com)
- 💰 Canadian Real Estate Association: [www.crea.ca](http://www.crea.ca)
- 💰 Canada Mortgage and Housing Corporation: [www.cmhc-schl.gc.ca](http://www.cmhc-schl.gc.ca)
- 💰 Gamblers Anonymous: [www.gamblersanonymous.org](http://www.gamblersanonymous.org)



# Getting and Managing Credit

Let's discuss...

- 🌱 Credit Worthiness – the “3 Cs”
- 🌱 Credit Rating
- 🌱 Advantages and disadvantages of credit
- 🌱 Signs you may be in debt trouble
- 🌱 What to do if you have a debt problem

## Your Credit Worthiness

If you want or need to borrow money, you will have to make sure the possible lender is confident that you are able to pay back the loan.



WHEN MIGHT SOMEONE NEED A LOAN? WHEN MIGHT A PERSON WANT A LOAN?  
WHAT'S THE DIFFERENCE? BE AWARE THAT IT MAY BE HARDER TO GET A LOAN  
WHEN YOU NEED IT THAN WHEN YOU DON'T.



Take action. Take control!

Try and arrange to have some credit available to you – even when you don't need it. Don't use it – just have it available in case you do need it. You may do this by the credit limit you have on a credit card or through a “line of credit” you set up with your financial institution.



Anyone thinking of lending you money will be interested in your “credit worthiness.” Your credit worthiness is simply a lender’s check on your ability to take on, carry, and pay back debt. To check your credit worthiness, a lender will consider the “3 Cs” — your capital, character, and capacity. These aren’t the only things that will be of interest to the lender. Your “credit rating” will also be very important. More on that shortly. But let’s look at the 3Cs so that you know about some of the things that might affect your chances of getting a loan.

## Capital

This refers to things you own. They have value and could possibly be sold if money was needed to pay back the loan. As you may know, things you own that have value are called “assets.” Your assets can include any “equity” you have in a house (that part of the house that you own — the value of the house minus the mortgage), stocks, bonds, cars, savings, and so on.

As a borrower, you would probably not have any intention of selling these assets or cashing them in to pay back the loan. However, if for some reason you were unable to make the payments or pay back the loan in full, then the lender wants some protection. The lender would like to know what assets you own that could be cashed in or sold (“liquidated”) to get the money needed.



**DO YOU HAVE ANY “ASSETS” AT THE MOMENT? YOU MAY NOT USE THEM TO GET A LOAN — BUT MANY YOUNG PEOPLE SELL THINGS THEY OWN TO GET MONEY, E.G. COMPUTER GAMES, USED SPORTS EQUIPMENT, USED MUSICAL INSTRUMENTS, USED BIKES, ETC. THESE ARE THINGS OF VALUE — ASSETS — SINCE THEY CAN POSSIBLY BE TURNED INTO MONEY BY SELLING THEM.**

Assets that you use to “secure” a loan — show you could find a way to pay back a loan if need be — are called “collateral.” The problem some people face is that they may not have much collateral to back a loan.

In that case, the lender may ask for someone to “co-sign” the loan. A co-signer is someone who will agree to pay back the loan if the borrower, for some reason, is not able to repay. Asking someone to co-sign a loan is asking them to take on a serious responsibility. And being a co-signer is taking on considerable responsibility. Any co-signer should be careful before co-signing a loan — a loan he or she may have to help repay.

So your “capital” is the assets that you have, to provide some possible “collateral” if needed. If you don’t have capital, the lender may ask for a co-signer — another person who will take on some responsibility for the loan. Now, how about your character?



IF SOMEONE ASKED YOU FOR A LOAN, WHAT MIGHT YOU WANT TO KNOW ABOUT THEM BEFORE MAKING YOUR DECISION? WOULD YOU LEND MONEY TO YOU AT THIS POINT? WOULD YOU BE A GOOD “CREDIT RISK?” WHAT CHANGES ARE LIKELY TO HAPPEN IN YOUR LIFE THAT MAY CHANGE YOUR CREDIT RISK?

## Character

When you apply for a loan, the loans officer will also be interested in your “character” – how responsible you seem to be and how reliable you are likely to be in repaying the loan.

Some of the questions that you have to answer on a loan application may surprise you. You may be asked how long you have worked at your current job; how long you have lived at your current address; and whether you have incurred any other debts; whether you are married; and if you have any dependents.

Why such questions? The lender (creditor) will be looking for signs of “stability,” “responsibility,” “reliability,” and so on. Being with an employer for quite a while, living at the same address for some time, being married, or having children or other dependents tend to be signs of stability and that you have taken on responsibility. This doesn’t mean that you can’t get a loan if you aren’t married with two kids and haven’t worked and lived at the same place for ten years. It also doesn’t mean that you will get a loan if you have. It does mean that if you have changed jobs frequently, are unemployed, or have moved from place to place, or have been married three times you may encounter some hesitation from loans officers when you apply for a loan. The lender will be looking to learn something about you – and the kind of person you are. You would probably want to know something about a person who asked you for a loan too.



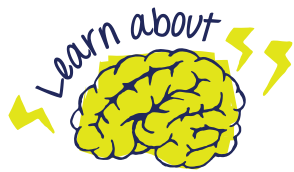
OF PEOPLE YOU KNOW WELL, WHO WOULD YOU BE WILLING TO LEND MONEY TO IF ASKED –AND IF YOU HAD THE MONEY TO LEND? ARE THERE OTHERS TO WHOM YOU WOULDN’T LEND MONEY? IF SO, WHY NOT? WHAT DIFFERENCES ARE YOU THINKING ABOUT WHEN YOU CONSIDER WHETHER YOU WOULD LEND THEM MONEY OR NOT?

We’ve looked at your capital (what you own) and your character (indications of the kind of person you are). Now how about whether you can afford the loan? That’s your capacity.

## Capacity

The creditor will also want to know if you can afford the payments on the loan. Do you have enough income to pay the monthly cost? Do you have other expenses that may make it hard for you to make the monthly payments? Do you have other debts? What you own, what you owe, and what you earn will be of interest to the possible lender.

These, then, are “the 3 Cs” that help to show your credit worthiness – and whether you are a credit risk. However, your credit rating will probably be as, or more important, to the lender if you are looking for a loan.



**CHECK OUT ONLINE WHAT IT WOULD COST PER MONTH TO CARRY DIFFERENT SIZE LOANS AT DIFFERENT INTEREST RATES. FOR EXAMPLE, SEE WHAT THE MONTHLY COST IS FOR A 5 YEAR LOAN OF \$10,000 AT 7% INTEREST. CHECK OUT A VARIETY OF OTHER LOANS FOR DIFFERENT AMOUNTS OF MONEY, FOR OTHER LENGTHS OF TIME, AND DIFFERENT RATES.**

## Credit Rating

Many people don't know a credit rating system exists. But it does. Those who are in the business of lending money share information. They share information about people to whom they have loaned money. They share information about those who have been good in repaying their debts – and making payments on time. They also share information on those who have not been so good – or who regularly make payments late – or who have not paid their debts.

For example, suppose you purchased something from a store on a credit card. Then, for some reason you did not pay the charges on the card. If that happens, the credit card company will probably first try and get you to pay the charge. If you still don't pay, the credit card company may notify the “credit bureau.” And that can go on your record and may affect your ability to borrow money.

There are a number of “credit rating agencies” that keep this information. For example, two large agencies in Canada are “Equifax” and “TransUnion Canada.” They keep records on people who borrow money – who they borrow from, how much they have borrowed, how good they are at repaying their debts, and so on. They also have information on bills you may not have paid – and should have. Based on all the information they have, they will calculate a credit score. The credit bureaus will make the information they have available to other lenders. Therefore, before making a loan, lenders will usually check with the rating agencies and check out your credit score.

Now here is a very important point. You can go to these companies to check out your credit rating – and you should. You may find things there you didn't know about – or you may find things that are wrong. A lender may have sent in notice that you didn't pay a debt – but you did, only late. But it may show on your credit rating that you never paid the debt – and that won't help your credit score.





DO YOU KNOW IF YOU HAVE A CREDIT RATING? HAVE YOU BORROWED MONEY?  
DO YOU HAVE A CREDIT CARD?



Go online to the two credit agencies to see if you have a credit rating. If so, you may want to check and see if the information is correct. If you don't have a credit rating now, check back now and then to keep an eye on it. You should always be in touch with your credit rating. It's important.

Most creditors will work with a borrower to try and help the borrower repay the loan before providing any information to the credit bureau that would hurt a person's credit rating. After all, their goal is to get their loan back or have the bill paid. They may work out new terms with you to help you. That is why it is always important to contact the creditor if you are having problems repaying a debt or paying a bill that is overdue. You can often work out a payment plan. However, if a creditor does not hear from you, they may simply assume you aren't going to pay what is owed and send that information to the credit bureau.

Before information is sent to the credit bureau, people who are having trouble paying their debts or bills will often be contacted by a "collection agency." A collection agency will work for those to whom you owe money. Their job is to try and get you to pay. It is best to get in touch with anyone to whom you owe money – and haven't paid – before they get a collection agency to get in touch with you. If you are contacted by a collection agency about a debt, take this as a warning and deal with the matter right away so that you don't end up with a negative report going to the credit agency.



If you have trouble making loan payments, paying back a loan, or paying a bill that you owe, contact whomever it is you owe money to. Let them know you are having some difficulty. See if they can work with you to help. Try to do that before the matter is put in the hands of a collection agency – or recorded at the credit bureau.

Even if you don't have any intention of borrowing money, you never know when the need may arise. It is always wise to be able to borrow money just in case you have to some day. That means having a good credit rating.

The following are some tips for maintaining a good credit rating:

- repay your debts and make payments on time
  - don't borrow more than you can afford
  - set a borrowing limit and stick to it. This sounds easier than it is. Most people don't know how to set a credit limit – that is, the maximum amount you can afford to borrow. Here is one suggestion. Set up a budget. (See the chapter on budgeting.) As you do, see how much you could afford each month for debt payments. That amount should help set your debt limit. If you borrow money, don't borrow more than could be covered by the limit you have set.
- The cost of a loan will vary with how much you borrow, how long you will take to pay it back, and the interest rate. Therefore, the maximum amount of debt that you can comfortably afford to carry will change as these things change. Try to stay in your “comfort zone” and borrow only what you can afford.
- don't sign any kind of loan agreement until you have read it thoroughly, understand it, and know what you are getting into. Sometimes you may feel a little awkward doing this. It may be a person you know. Or the person may make it seem like time is short and you should hurry – or that this is just standard stuff and you shouldn't worry about it. Or it may be that the document is quite lengthy and may take some time to read over. Don't let that stop you. Most people will understand that you want to read what you are signing. If they don't, it may be because they really don't want you to read it. Even if you feel awkward, take the time. It is a small price to pay to be comfortable with what you are signing.
  - never sign a blank form of any kind where information could be filled in or added after you sign
  - always try to pay your monthly bills on time (like phone, electricity, etc.)
  - contact your creditors if you are having trouble making payments on your debts
  - deal with reputable creditors (they should have a good credit rating too)
  - be cautious about co-signing for a loan

As we noted, co-signing a loan is a serious responsibility. A parent may co-sign a loan for a child if the child is still relatively young and needs help with borrowing money. That is quite common until there has been time for the child to build up a credit rating. But always think carefully if you are asked to co-sign for a loan. It may affect your own credit rating if things go wrong.



### Take action. Take control!

Don't just wait for your credit rating to be built up by others – try and build a good credit rating for yourself. If you can borrow some money without paying interest – like with some credit cards – and pay it back promptly and in full – consider doing this to build a good rating. Also, if you rent an apartment and pay electricity bills (on time), and phone bills, (on time), etc., this will show on your credit rating. So don't just let your credit rating happen. Try and do some things, as you can, to build a good credit rating.

It's also a good idea to start to develop a good credit rating as early as possible. To do this, some young people decide to get a credit card from a retailer or credit card company, make purchases, and pay off the bills promptly and fully each month. In this way, a good credit rating can begin to be established even at a relatively young age.

Many people borrow money by using a credit card or taking out loans to buy things. How you use a credit card or manage a loan can affect your credit rating. Let's take a look at some of the advantages and disadvantages of using credit through credit cards and loans.

## The Advantages and Disadvantages of Credit

### Advantages

- You can use something and enjoy it now (for example, a car, a house, a vacation, education, new clothes) and pay for it out of future income.
- You can buy things you could not buy from your current income. You can use some of your future income to pay for it.
- Credit enables you to handle emergencies and unexpected costs due to an illness, accident, losing a job, car repairs, and so on.
- Credit can enable you to pay more to buy goods of higher quality that you otherwise could not afford now. Buying better quality can mean it will last longer. That may make it a wise consumer choice.
- You can take advantage of sales and deals – if a really good one comes along. (Just make sure that the amount you save through the sale is more than it may cost you in interest.)
- Using a credit card provides you with a record of your expenses. Credit card issuers provide a monthly statement which lists all of the spending you did with the credit card.
- Credit can make it easier to deal with a number of debts you have if you are having difficulty repaying. By taking out a “consolidation loan” you can borrow one amount to pay all or most of your bills and then make a single payment each month rather than many.

### Disadvantages

- Credit can encourage you to live beyond your means and get you into financial difficulty.
- Credit can mean that your future income will be tied up in paying past debts. You may not be able to buy things in the future that you wish you could.
- Using credit can increase your total cost for a product or service since the interest you will pay must be added to the price.
- Credit can lead to more impulse buying, which may lead to buying things you don't really need – and wish you hadn't.
- If you get and use a credit card for a particular store, you may just shop there and do less comparison shopping. You may lose out on cheaper prices or better deals elsewhere.
- Tapping into credit now will mean that you will have less available if unforeseen emergencies arise.



One way to keep a good credit rating is to avoid getting into debt trouble. When you “get in over your head” and have more debt than you can afford, you can start missing payments, paying late, or not repaying your debts. That can lead to problems with your credit rating. So avoiding debt trouble in the first place is the wise thing to do. But how do you know if you are heading toward debt trouble? Let’s take a look at some of the signs that you may be headed in the wrong direction.

## Signs That You May Be in Debt Trouble

You may be heading for debt trouble if you find you are:

- finding it difficult to save anything;
- continually short of money;
- using your savings to pay debt costs;
- near your credit limit on all or most of your credit cards and accounts;
- missing payments or due dates for your bills;
- always making only the minimum payments on your credit cards and accounts. Each month you will likely see a “minimum” monthly payment on your credit card statement. This is the minimum amount that the lender is willing to take as payment for that month. It is not the minimum you would be best to pay. The best thing is to pay off the full amount. If you can’t, pay off as much as you can. If you just make the minimum monthly payment it can take a long time to pay back the money – and you end up paying a great deal of interest;
- unaware of how much you owe;
- worrying a lot about money – your debts are always on your mind – you are having trouble sleeping;
- borrowing money to pay off past debt costs; and
- having to borrow money to meet your week-to-week or month-to-month living expenses.



DO ANY OF THESE SIGNS APPLY TO YOU? EVEN AT A YOUNG AGE, ARE YOU POSSIBLY HEADING FOR SOME DEBT PROBLEMS OR ARE YOU WELL IN CONTROL? WHAT DO YOU SEE AS YOUR LIKELY “DEBT FUTURE?”



## What To Do If You Have a Debt Problem

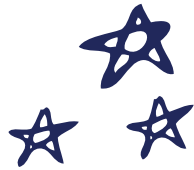
Do all that you can to avoid debt problems. Know how much debt you can afford and don't go over that limit. Set up a budget so you know how much debt you can afford. Don't borrow to that limit – leave yourself some room in case something comes up. Think about the trade-offs you are making when you borrow money – and borrow only when it is a good decision for you.

But in the end, some people will get into debt trouble. What can you do if that happens?

- Perhaps the most important advice for you if you are having debt troubles is to face up to your problems and start to do something about them. Don't try to handle it all alone. If you have close personal friends or family, seek their help and advice. They can also help you deal with what may be a bad situation. You will probably be surprised at how many people will understand and will try to help see you over a rough period.
- Contact your creditors. Don't simply start missing payments. Most of those who have loaned you money will try to help you get out of the hole you are in. After all, they have an interest in helping you – they hope to get their money back. Work out a new payment schedule with them. You will probably be surprised at how co-operative most creditors will be.
- Put all of your credit cards away to avoid getting into worse trouble. In fact, stop all further borrowing. No sense digging a deeper hole.
- Consider a consolidation loan for your debts. A consolidation loan is one loan you take out to pay back your other loans. In this way you can turn a number of payments for a number of different loans into a single payment for one loan. The monthly cost may be less than the total monthly cost of all other payments combined. If you are carrying debt on credit cards, the interest you will pay on a regular loan will usually be much lower than that on a credit card balance.
- Consider a second job, if you can, to see you over the hurdle and tough times.
- Cash in some investments or savings to lower your debt position. The costs you pay on your debt will usually be greater than the interest you earn on your investments. It may make sense to give up the investment to do away with the debt.
- Seek some professional advice and counselling if you can get it – or if someone will help you get it.
- Review your lifestyle and past decisions. What got you into trouble? What could you change to get out of trouble? What can you give up to get money to help you pay your debts?

When it comes to handling money, and making good money decisions, few things are more important than getting and keeping a good credit rating. Right from the outset, make that one of your priorities. Debt can help you – or debt can hurt you. Borrow wisely. And always stay within a limit you can afford.





## Chapter Summary

### Say What? Possible New Terms!

1. **Capital:** the assets you own — things of value — things that could be sold or cashed in, if needed, to help pay back a loan.
2. **Character:** things about you that indicate your degree of stability, responsibility, and reliability.
3. **Capacity:** your ability to make payments on a loan — usually determined by your income.
4. **Credit rating:** a score that indicates your history of managing and paying your bills and debts.
5. **Collateral:** something of value that you put up in support of a loan and that could be sold, cashed in, or given to the lender if a loan can't be repaid.
6. **Co-signer:** a person who signs a loan agreement who is willing to pay back the loan, or what is owing on a loan, if the borrower can't repay.
7. **Consolidation loan:** one loan taken out to pay off a number of debts to make one payment monthly rather than a number of payments to hopefully reduce the monthly cost.

### Did It Stick? Can you recall ...?

1. What are the “3Cs”? Why are they used?
2. What is your credit rating? What kinds of things can affect your credit rating?
3. How can you build a good credit rating?
4. What are some signs that you might be heading toward debt problems?
5. What are some things you can do if you have debt problems?
6. What are some of the advantages and disadvantages of using credit cards and loans?

### Thinkabout ... or discuss:

- 💰 How can a young person build a good credit rating?
- 💰 Is it too easy for young people to get credit these days?
- 💰 What leads some young people to get into debt difficulties at a young age?
- 💰 How might borrowing help a young person as he/she tries to build a successful future and achieve goals?

### Tips and Suggestions

- 💰 Protect your credit rating. Pay bills — and pay them on time. Pay debts — and pay them on time.
- 💰 Know your credit limit — and stick to it. Know what you can afford — and leave some room if you can in case surprises come along.
- 💰 Know how borrowing can help and use it to your advantage. Know how borrowing can hurt, and avoid debt issues.

### Tech-Talk

If you can, use the Internet to:

- 💰 See if you have a credit rating — and, if so, check it out.
- 💰 Compare the cost of carrying different amounts of loans over different periods of time at different rates of interest.
- 💰 Search:
  - Building and keeping a good credit rating
  - How to pick the right credit card
  - Signs of debt trouble
  - Credit Canada — Debt Solutions
  - Financial Consumer Agency of Canada