Teacher's notes

Borrowing money from friends/family

People can borrow money from a friend or family member, in which case the arrangements for paying the money back are entirely up to the individuals. Although friends and family are less likely to charge you interest and will probably be more flexible with repayment, borrowing money from people close to you can sometimes put a strain on your relationship.

In comparison, borrowing from a bank or building society is a business transaction with clearly defined rules to follow.

> Fact:
> In November 2004 the Bank of England announced that the amount of money borrowed by UK consumers had reached 1 trillion pounds.
> That's:
> £ 1,000,000,000,000
> Citizens Advice has seen a 44% increase in the number of people seeking help for debt problems over the past six years.

Ways of borrowing money

- Loans
- Overdrafts
- Credit cards
- Credit agreements
- Interest free credit
- Store Cards
- Hire purchase
- Consolidation loans
- Mortgages

LOANS
When a consumer borrows money from a bank or other lender they enter into a contract with them, which governs the repayment. You have to be 18 years old to be able to enter into such a contract.

For example, a consumer arranges to borrow £500 from a bank:
The bank will offer a period of time over which the money can be repaid usually stated in months e.g. 12, 18, 24 months etc. The bank will tell consumers what their interest rate is stated as Annual Percentage Rate or

APR. They will tell consumers how much interest is charged per month and how much the monthly repayments will be.
They should also total these figures up so consumers can see how much they are paying in total for the length of the loan.

A consumer will also agree the means of payment e.g. standing order, cash payments, cheques, etc and the date each month when they must pay.

Examples:
Consumer wants to borrow £1000 as a loan and they compare the price of repayments over 12 months, 18 months and 24 months.
The interest rate is 17.8% APR
The bank gives the following figures:

Loan amount: £ 1000.00   Typical APR: 17.8 %
Term: 12 months
Initial repayment: £ 90.91
Subsequent monthly repayments: £ 90.97
Total amount repayable: £ 1091.58

Loan amount: £ 1000.00   Typical APR: 17.8 %
Term: 18 months
Initial repayment: £ 62.93
Subsequent monthly repayments: £ 63.10
Total amount repayable: £ 1135.63

Loan amount: £ 1000.00   Typical APR: 17.8 %
Term: 24 months
Initial repayment: £ 49.18
Subsequent monthly repayments: £ 49.20
Total amount repayable: £ 1180.78

The **Annual Percentage Rate** of the total charge for credit **(APR)** is a standard way of measuring the real cost of credit to the customer, expressed as an annual rate. The APR is different to a flat rate of interest and more accurately reflects the true cost.
The formula for calculating the APR is very complex, but basically the interest and all other charges made for granting the credit (the total charge for credit) are totalled and then expressed as an annual rate.

Payment Protection Insurance
When a consumer borrows money most lenders will offer you a form of payment protection insurance. This gives protection in the case that a consumer is suddenly unable to pay, for example due to ill health, an accident or loss of a job.
It can cover car finance, personal loans, credit cards and store cards, catalogue debts and mortgages. An amount for insurance is added to monthly repayments.

Payment protection insurance is normally optional but some credit arrangements make it compulsory. Most payment protection insurance agreements pay only a part of the balance each month, for a limited period. The most common amount paid is 10% for ten months. The amount paid off is always equal to or more than the minimum monthly payment required by the credit card or store card company.

OVERDRAFTS

A overdraft is an agreement with a bank to take out more money from a current account than it currently contains.
For example, an overdraft limit of £200 on an account means all the money in the account can be spent plus another £200.
An overdraft can be a good way to borrow money short-term or to have some funds available to cover emergencies.

CREDIT CARDS

Credit Cards provide a separate account from which a consumer can borrow money. They can use the card to pay for goods or services in shops, by phone or via the internet.
When a consumer obtains a credit card they will have a credit limit. This is the amount of money they can borrow.
Each month they will be sent a statement which shows:

- Each item of spending
- The total balance
- The interest charged
- The minimum amount you can repay this month, usually 5% of the total balance

Charge cards

The difference between a charge card and a credit card is that the amount borrowed on a charge card must be repaid in full at the end of a given period, usually a month. Interest is not charged on the amount but a consumer may have to pay an annual fee for the card.

American Express and Diners Club are the two major operators.

Credit agreements

Under credit sale, a consumer buys the goods at the cash price.

They usually have to pay interest but some lenders offer interest-free credit. Repayment is made in instalments. they are the legal owner of the goods as soon as the contract is made and the goods cannot be returned if you change your mind. The supplier cannot repossess the goods if a consumer falls behind in repayments but can take court action to recover the money owed if repayments are not kept up.

Credit sale agreements are now more common than hire purchase agreements and it is important not to confuse the two.

Interest free credit
This is potentially a good way to purchase goods though it is not often available. A consumer does not pay any more than the cash price but they have a period of time to pay for what you've bought.

Store Cards
Store cards are the cards that many major retailers offer their customers as a convenient way of buying goods in their stores, often with incentives attached such as special discount and privileges.

A store card generally

- Is considered as another payment method amongst others such as cash, credit cards etc
- Has a lower credit limit than a credit card, and
- Can be used only at the issuing retailer store

Store cards operate similarly to a credit card with a monthly statement being sent to all customers with the requirement to pay off at least the minimum payment.

Hire purchase (HP)
Under a hire purchase (HP) agreement, a consumer hires goods until they pay the final instalment. They will not own the goods until then.

This means that they can end the agreement and return the goods at any time. However, they will owe any overdue instalments and, if less than half of the total price has been paid, they may also have to pay the difference.

The company which has made the loan (the lender) may be able to take back (repossess) the goods if, for example, a consumer falls behind with payments. The lender does not have to sell the repossessed goods to reduce your debt.

Mail order
Mail order shopping is usually arranged through a catalogue and is normally interest free, the customer paying only the price of the purchase in instalments. However, goods bought in this way may be more expensive.

Doorstep sellers
Selling or promoting goods or services on credit by calling at people's homes is illegal unless the company has a licence to sell credit outside their trade premises. Common examples are double glazing or home improvements. Any agreement that is made illegally may not be enforceable.
It is a criminal offence to try to make a cash loan outside trade premises unless the visit is made to your home in response to a written and signed request. Any agreement that is made illegally may not be enforceable.

Credit unions
A credit union is a self-help co-operative whose members pool their savings to provide each other with credit at a low interest rate. If a member fails to repay a loan, the credit union can seek repayment through the courts.

Credit unions encourage people to save what they can and only borrow as much as they can afford. After you have been saving with the credit union for a few months you can apply for a loan.

The maximum interest charge is 1% per month.

Pawnbrokers
Pawnbrokers lend money against the value of property left with them. They must give a receipt known as a ticket. Pawnbrokers agree to keep the property for at least six months but consumers can get it back at any time during that period by paying off the loan plus interest. The period can be extended by paying the interest only and re-pledging the property.

"Loan sharks"
Loan sharks lend money to people who are usually unable to borrow from other sources. They charge very high interest and are not concerned by your ability to repay. They may force you to take out a second loan to repay the first.
If a consumer gets behind with payments a loan shark may threaten them. This is illegal.

Consolidation Loans
A consolidation loan is a loan to pay off all existing debts from whatever source such as credit cards, loans, overdrafts etc.
From then on a consumer only makes repayments to the new creditor. The advantage of this is only one payment to remember.
The disadvantages can be higher interest rates and consequences if a consumer does not make payments on time.
Consolidation loans are usually secured against a consumer's home and therefore are only available to home owners. If a consumer fails to keep up the repayments they could lose their home.

Mortgages
If a consumer wishes to buy a home they may be able to borrow money to do this. This is called a mortgage. The loan is for a fixed period usually 25 years and interest is charged on the loan. If a consumer does not keep up the agreed repayments, the lender can take possession of their home.

Mortgages are available from banks and building societies and also other lenders. This is a very competitive area and the lenders are constantly changing the types of mortgage they offer. Because of this it is not possible to cover this subject in detail here.