Loan To Own

FDIC Financial Education Curriculum
Welcome

1. Agenda
2. Ground Rules
3. Introductions
Objectives

• Identify various types of installment loans

• Identify the factors lenders use to make home loan decisions

• Identify how federal laws protect you when applying for a loan

• Identify the questions to ask when purchasing a car
Objectives

• Explain why installment loans cost less than rent-to-own services

• Explain why it is important to be wary of rent-to-own, payday loans, and refund anticipation loan services

• Guard against predatory lending practices
What Do You Know?

What do you know or want to learn about installment loans?
What is an Installment Loan?

• A loan that is repaid in equal monthly payments/installments for a specific period of time

• What items can be purchased with an installment loan?
  • Cars
  • Furniture
  • Computers
  • Household appliances
Secured Installment Loans

- Have lower interest rates than unsecured loans
- Require collateral
- Examples: Mortgages and home equity loans
Collateral

• **What does collateral mean?**
  • It is an asset you own and pledge to the lender if you cannot repay the loan

• **If you are unable to repay the loan and the collateral is insufficient to cover the balance, you are still responsible for:**
  • The remaining balance
  • Any fees and interest associated with the loan
Unsecured Installment Loan

• Not secured by collateral

• Tougher underwriting standards than secured loans

• Examples: personal loans and private student loans
Cost of Installment Loans

<table>
<thead>
<tr>
<th>APR</th>
<th>Finance Charges</th>
<th>Fixed-rate loan</th>
<th>Variable-rate loan</th>
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1. Dollar amount the loan will cost, including: interest, service charges, and loan fees
   Answer: Finance charges

2. Loan with interest rate that might change during any period of the loan
   Answer: Variable-rate loan
Cost of Installment Loans

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3. **Cost of borrowing money on a yearly basis**
   
   Answer: APR

4. **Loan with interest rate that stays the same throughout the term of the loan**
   
   Answer: Fixed-rate loan
Identify the Term

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1. Stephanie took out a car loan with a 10% interest rate and paid $100 in loan application fees. What lending term reflects the interest plus the application fee?

Answer: APR
Identify the Term

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2. Michael took out a loan to buy a computer. He must make 24 equal payments over 2 years at 10% interest. Which lending term best describes this type of loan?

Answer: Fixed-rate loan
3. Kevin took out a loan for a car. He must pay $3,000 in interest, service charges, and loan fees. What lending term(s) best describe(s) these costs?

Answer: Variable rate loan, Finance charges
Why Do Borrowers Prefer Installment Loans?

• Clear monthly payment amount and repayment period

• Lower rates than credit cards

• Lower loan balances during loan term because payment includes principal
Purchasing or Leasing a Car

- What are some questions to ask yourself when looking for a car?
  - Should I get a new or used car?
  - Should I lease or buy?
  - How much can I afford?
  - Should I trade in my old car?
Car Loans Versus Car Leases

• Consider:
  • Ownership potential
  • Wear and tear
  • Monthly payments
  • Mileage limitations
  • Auto insurance
  • Cost
Financing a Car

• The car is the collateral for the loan.
• The title indicates who owns the car.
• When considering a car loan:
  • Know the costs and how much you need to borrow
  • Shop for the best deal
Where to Obtain Car Loans

- Banks/thrifts
- Credit unions
- Finance companies
- Car dealerships
When Dealers Offer Low Interest Rates

• **The best deal may require:**
  • Large down payment
  • Short loan term (3 years or less)
  • Excellent credit history
  • Participation fee
Low Interest Rates

• Ask about:
  • Price of low-rate financing
  • Advantages of paying with cash/using your own financing
  • Down payment required
  • Limits on the length of the loan
  • Balloon payments, if due at the end of the loan
Special Promotions

• Ask about:
  • Trade-in allowance
  • Limits on special offers
  • Meaning of dealer’s invoice
Auto Service Contracts

• A promise to perform (or pay for) certain repairs or services

• Ask questions before buying auto service contracts.
Used Car: Warranty Protection

- Look for the Buyer’s Guide sticker to indicate whether the vehicle is being sold:
  - With a warranty
  - With implied warranties
  - “As is”
Alternative Fueled Vehicles

• Before buying or leasing, consider:
  • Fuel type and availability
  • Operating costs
  • Performance/convenience
  • Energy security/renewability
  • Emissions
Activity 1: Beware of Dealer-Lender Relationships

Complete Activity 1 in the Participant Guide.

1. Read the scenario carefully.
2. Write down some things that Sam could have done differently.
3. Be prepared to explain your answers.
Structuring a Car Loan

• Make as large a down payment as possible

• Consider the total cost of the loan:
  • Example: $15,000 at 4% interest for 36 months = $443 versus 48 months = $339 a month
  • Total cost: $15,948 versus $16,272

• Be cautious about taking on an auto loan term of 5 years or more
Beware of Car Title Loans

• You risk losing your car if you cannot pay.

• They can be costly loans.

• Example:
  • 1st month: $500 loan + $100 interest ($500 x 20%) = $600
  • 1 year: $500 loan + $1,200 interest ($110 x 12) = 240% APR
Equity

• The value of the home minus the debt

Value of home  $250,000  minus debt  - 180,000  Equity  $ 70,000

• A *home equity loan* allows you to borrow against the value of your home.
How Home Equity Loans Work

Appraised value of home: $250,000
Lender’s maximum loan-to-value ratio: 80%
Maximum you can borrow against the home:
$250,000 x 80% = $200,000

Maximum value of home equity loan:
$200,000 - $180,000 (existing mortgage)
= $20,000
Types of Home Equity Loans

• **Home Equity Loan:**
  - One-time loan for a lump sum
  - Typically at a fixed interest rate

• **Home Equity Line of Credit (HELOC):**
  - Line of credit that works like a credit card
  - Interest rates are typically variable
Borrowing Against Your Home

• What are the advantages of taking out a home equity loan?
  • Lower interest rates
  • Tax-deductible interest

• What is the danger of borrowing against your home?
  • Losing your home
  • Owing more than your home is worth
Right to Rescind/Right to Cancel

• You have 3 days to reconsider a signed home equity loan agreement and cancel the loan without a penalty when you use your primary home as collateral.
Is a Line of Credit Right for You?

• Can you afford the increased monthly payments after the introductory period ends or when interest rates rise?

• Are you comfortable with fluctuating monthly mortgage payments?

• Will you be investing your home equity in another asset of long-term value?
Unsecured Installment Loans

- Loans used for a variety of personal expenses with no collateral required
- Terms: 1 to 5 years
- Benefits: fast approval times, lower interest rates than credit card rates
- Drawbacks: Higher interest rates, stricter credit requirements
Refund Anticipation Loans

• Short-term loans secured by your income tax refund

• Example:
  • Refund: $1,500
  • Fees: - $300
  • Check to you: $1,200
Borrow From Yourself First

• Establish an emergency savings account
• Save at least 6 months of living expenses
• Consider making small, simple changes in your habits or banking practices to save
Comparison Shop

• If you must borrow money, look at both total dollar costs and APR

• Example:
  • $75 interest on a $500 loan for 2 weeks translates into 391% APR!
  • If you pay $75 to renew or roll over the $500 loan, you will owe more in fees ($525) in 14 weeks than the original loan!
Emergency Options for Cash

• Talk to your financial institution for loan options (e.g., line of credit)

• Build a savings fund
The Four Cs

• **Capacity:** your present and future ability to meet your payment obligations

• **Capital:** the value of your assets and your net worth

• **Character:** how you have paid bills or debts in the past

• **Collateral:** property or assets offered to secure the loan
Consumer Protection Laws

- Equal Credit Opportunity Act
- Truth in Lending Act
- Fair Credit Reporting Act
- Fair Debt Collection Practices Act
- Fair Credit Billing Act
Activity 2: How Lending Laws Protect You

Complete Activity 2 in the Participant Guide.

1. Read the scenario carefully.
2. Answer the questions.
3. Be prepared to explain your answers.
Resolving Complaints

• Write to the Federal Deposit Insurance Corporation (FDIC):
  • State the problem
  • Include pertinent information

• Send copies of documents that may help explain your problem
  • Keep the original documents

• Sign and date your letter
Additional Consumer Protection Laws

- Servicemembers Civil Relief Act
- Real Estate Settlement Procedures Act
- Fair Housing Act
- Consumer Leasing Act
Predatory Lending Practices

- Includes the use of:
  - Certain marketing tactics
  - Abusive collection practices
  - Loan terms that deceive and exploit borrowers
- Occurs in mortgage, home equity, credit card, auto lending, and payday lending markets
Subprime Lending

• Involves extending credit to borrowers with a poor credit history:
  • Most predatory loans are made to subprime borrowers, but not all subprime loans are predatory.
  • Interest rates and loan fees may be higher to offset the higher costs associated with lending to these borrowers.
Predatory Payday Loans

• Small cash advances minus the lender’s fees
  • Example: You agree to pay $230
  • You receive $200
  • Lender fees: $30 (which equals 390% APR)
Predatory Mortgage Lending Practices

• Excessive fees
• Abusive repayment penalties
• Kickback to brokers (yield spread premium)
• Loan flipping
• Unnecessary products
• Asset-based lending
• Steering and targeting
Activity 3: Predatory Lending Practices

Complete Activity 3 in the Participant Guide.

1. Read the scenario carefully.
2. Answer the questions.
3. Be prepared to explain your answers.
Summary

• What final questions do you have?

• What have you learned?

• How would you evaluate the training?
Conclusion

• You learned about:
  • Secured and unsecured loans
  • The cost of loans
  • Car loans and auto financing
  • Home equity loans
  • The Four Cs of loan decisions
  • Predatory lending practices