Lesson D1–2

Understanding the Concept of Borrowing Money

Unit D. Basic Agribusiness Principles and Skills

Problem Area 1. Managing Personal Finances

Lesson 2. Understanding the Concept of Borrowing Money

New Mexico Content Standard:

Pathway Strand: Agribusiness Systems

Standard: **III:** Apply generally accepted accounting principles and skills to manage budget, credit, and optimal application of AFNR business assets.

Benchmark: **III-A:** Use key accounting fundamentals to accomplish dependable bookkeeping and associated files.

Performance Standard: **1.** Budget resources (e.g., capital, human, financial, time).

Student Learning Objectives. Instruction in this lesson should result in students achieving the following objectives:

1. Understand what a lender looks for in a borrower.
2. Understand good characteristics of a lender.
3. Understand the concept of establishing credit.
4. Calculate the cost of credit.

List of Resources. The following resources may be useful in teaching this lesson:

Recommended Resources. One of the following resources should be selected to accompany the lesson:

Decisions & Dollars. Alexandria, Virginia: The Council for Agriculture Education,. 1993. (Curriculum Binder, Unit I)

Other Resources. The following resources will be useful to students and teachers:

High School Financial Planning Program. National Endowment for Financial Education and Cooperative Extension Service. 1992.

Barry, Peter, et. al. *Financial Management in Agriculture*, Sixth Edition. Danville, Illinois: Interstate Publishers, Inc., 2000.

List of Equipment, Tools, Supplies, and Facilities

Writing surface
Overhead projector
Transparencies from attached masters
Copies of student lab sheets

Terms. The following terms are presented in this lesson (shown in bold italics):

Add-on interest
Collateral
Credit rating
Interest in advance
Lender
Percent per month
Simple interest

Interest Approach. Use an interest approach that will prepare the students for the lesson. Teachers often develop approaches for their unique class and student situations. A possible approach is included here.

Have two students role play. Have one student approach a bank loan officer for an auto loan. After the role play ask the students for any suggestions of questions that should have been asked. Relate to the students the objectives for this lesson.

Summary of Content and Teaching Strategies

Objective 1: Understand what a lender looks for in a borrower.

Anticipated Problem: What does a lender look for in a borrower?

I. A ***lender*** is an institution or individual who loans money.

A. A borrower must be of good character.

1. Character refers to the reputation of the borrower.
2. Often times lenders will ask for character references.

B. Financial position of the borrower is important.

1. Financial position refers to overall economic position.
2. Lenders will ask for a listing of assets, debts, etc. to determine financial standing.

C. A borrower must prove the capacity to repay the loan.

1. A monthly budget is often viewed.
2. The lender wants to know that there is enough income to cover all of the monthly financial obligations.

D. Security of the loan is another consideration.

1. The lending institution must know that if the loan goes unpaid they will be able to recover their money.
2. ***Collateral*** is property that will be taken if repayment is not made.
3. Real estate and vehicles usually act as collateral for home mortgages and car loans.
4. A loan for a vacation may require collateral.

Use Decisions & Dollars Unit I.D as a reference. Use TM: D1–2A to explain the characteristics of a good borrower.

Objective 2: Understand good characteristics of a lender.

Anticipated Problem: What are good characteristics of a lender?

II. A borrower must feel comfortable with and trust the lender.

A. A lender should be of good character.

1. A question to consider is: "Does this lender have a good reputation in the community?"

B. Lending policies should be examined.

1. Some loans may be sold in the secondary market.
2. Is mortgage insurance required?
3. Are business hours of the institution convenient?

C. Permanence of the lending institution should be considered.
   1. How long has the institution been in business?
D. Cost of the loan is another consideration.
   1. Institutions vary on the interest they charge.
   2. Carrying charges vary by institution.

Use Decisions & Dollars Unit I.D to explain this objective. Use TM: D1–2B to explain the characteristics of a good lender.

Objective 3: Understand the concept of establishing credit.

Anticipated Problem: How can I establish good credit?

III. Lending institutions want proof of the ability and willingness to pay.
   A. Steps can be taken to obtain a good ***credit rating***.
      1. Open a checking account to demonstrate the ability to manage money.
      2. Open a savings account to show a good record and provide collateral.
      3. Buy an item on a lay-away plan to show the willingness to pay.
      4. Apply to a department store or gasoline company for a credit card. Make small purchases and pay for them when the bills come.
   B. When difficulties are encountered in paying bills in a timely manner, it is best to contact the lender to discuss alternative plans for repayment.

Use Decisions & Dollars to assist with this objective. Use TM: D1–2C to discuss ways to establish a good credit rating. Assign LS: D1–2A for students to investigate credit applications.

Objective 4: Calculate the cost of credit.

Anticipated Problem: What costs are involved with credit?

IV. Credit is not often given without cost.
   A. The annual percentage rate (APR) is the interest charge on the loan per year.
   B. *Simple interest* is a method of calculating interest charges on the outstanding balance for the number of days the money is used.
      1. If you borrowed $1,000 for one year at 7% interest, you would expect monthly payments of $89.17, ($1,000 × 1.07 ÷ 12). If you paid the loan off after the first payment you would pay $916.67 [$1,000 – ($1,000 ÷ 12)]
   C. With ***add-on interest***, the borrower pays interest on the full amount of the loan for the entire loan period. Interest is charged on the face amount of the loan at the time it is made, then the principal and interest are added together and divided equally by the number of payments to be made.

1. If you borrowed $1,000 for two years at 7% interest, you could expect to pay a total of $140 in interest ($1,000 × .07 X 2).

D. Using ***percent per month***, interest is calculated month by month on the unpaid balance.
   1. The charge might be 2 ½ % per month up to $300, 2 % up to $500, 1 ½ % up to $1,000, and 1% over $1,000.

E. The ***Interest in advance*** method means the interest is calculated then subtracted from the principal before the borrower actually receives it.
   1. If a borrower took a one-year loan for $1,000 at 7% interest, she would receive only $930 at the start of the loan.

Use Decisions & Dollars Unit 1.D as a reference for this objective. Assign LS: D1–2B for students to practice figuring interest charges. Invite a loan officer from a local bank to discuss this objective and the previous objectives of this lesson.

Review/Summary. Focus the review and summary of the lesson around the student learning objectives. Call on students to explain the content associated with each objective.

Application. Application can involve one or more of the following student activities using attached lab sheets:

LS: D1–2A – Comparing Credit Applications
LS: D1–2B – Calculating Interest Charges

Evaluation. Evaluation should focus on student achievement of the objectives for the lesson. Various techniques can be used, such as student performance on the application activities. A sample written test is attached.

Answers to Sample Test:

Part One: Matching

1 = f, 2 = b, 3 = g, 4 = a, 5 = c, 6 = e, 7 = d

Part Two: Completion

1 = character
2 = repayment capacity
3 = secondary market
4 = annual percentage rate
5 = mortgage insurance

Part Three: Short Answer

1. Open a checking account to demonstrate your ability to manage money. Open a savings account to show a good record and provide collateral. Buy an item on a lay-away plan to

show your willingness to pay. Obtain a department store or gasoline company credit card, make small purchases, and repay in a timely manner.

2. $25,000 × .049 × 4 = $4,900
   $4,900 + $25,000 – $29,900
   $29,900 / 4 years = $7,475

Sample Test Name_____

Test

Lesson D1–2: Understanding the Concept of Borrowing Money

Part One: Matching

Instructions. Match the term with the correct response. Write the letter of the term by the definition.

a. add-on interest
b. simple interest
c. interest in advance
d. percent per month
e. credit rating
f. lender
g. collateral

_____ 1. An institution that provides money and is paid interest in return.

_____ 2. Interest paid only for the number of days money was used.

_____ 3. Item pledged to secure a loan.

_____ 4. Interest and principal payment paid equally over the life of the loan.

_____ 5. Interest charge subtracted from the amount of the loan.

_____ 6. Proof of one's willingness or ability to pay for a loan.

_____ 7. Interest is figured on a monthly basis.

Part Two: Completion

Instructions. Provide the word or words to complete the following statements.

1. _____ refers to your reputation.
2. A monthly budget is often used by a lender to determine your _____ _____.
3. When a bank no longer administers your loan, they sell it on the _____ _____.
4. The interest charge for a loan is quoted as the _____ _____ _____.
5. _____ _____ protects the lending institution in case you are unable to repay a mortgage.

Part Three: Short Answer

Instructions. Provide information to answer the following questions.

1. What steps can be taken to establish a good credit rating?

2. If you take a $25,000 loan for 4 years at 4.9% interest, what would the monthly payments using add-on interest?

TM: D1–2A

Characteristics of a Good Borrower

- Character
- Financial position
- Capacity to repay
- Security of the loan

TM: D1–2B

Characteristics of a Good Lender

- Character
- Fair lending policies
- Permanence of the lending institution
- Cost of the loan

Steps in Obtaining a Good Credit Rating

- Open a checking account to demonstrate your ability to manage money.
- Open a savings account to show a good record and provide collateral.
- Buy an item on a lay-away plan to show your willingness to pay.
- Apply to a department store or gasoline company for a credit card. Make small purchases and repay in a timely manner.

Name _____

Lab Sheet

Comparing Credit Applications

Purpose:

1. To show the information requested to obtain credit.

Procedure:

1. Obtain a credit application from a bank, credit union, or for a credit card.
2. Complete the application and bring it to class.

Questions to answer:

1. What are the major categories of information requested?

2. How many references are requested?

3. Why is the institution interested in your monthly rent/mortgage payment?

4. What is the purpose of giving your checking and savings account information?

Name _____

Lab Sheet

Calculating Interest Charges

Purposes:

1. To learn to calculate interest charges.
2. To compare types of interest methods.

Procedure:

1. Using the information below, answer the following questions.

1. You borrowed $10,000 for one year at 8.9% interest and the bank charges simple interest. How much interest will you pay if you pay the loan off in 3 months?

2. What would your monthly payment be if the loan in #1 is figured using add-on interest method?

3. How much money would you leave the bank with if the loan is figured using the interest in advance method?

Lab Sheet Key

Figuring Interest Charges

Answers:

1. $10,000 × .089 × 3 ÷ 12 = $222.50

2. $10,000 × 1.089 ÷ 12 = $907.50

3. $10,000 – $10,000 × .089 = $9,110