PATHFINDERS

Borrowing Toolkit

Pathfinders is a 501(c)(3) non-profit organization that assists families on their way to economic self-sufficiency. As a partner in The United Way of Tarrant County's Financial Stability Initiative, **Pathfinders** provides financial coaching to low and moderate income people who are trying to improve their financial outlook.

Financial coaching goes beyond financial education to focus on individual financial practices that will lead to financial stability. This is your opportunity to work with a trained financial coach to identify changes you can make to attain your goals.

Benefits of Borrowing

- Responsible borrowing allows you to afford things that are important while protecting you against owing more than you can afford to repay
- Short-term credit can help you gain access to longer-term credit like buying a house, car or paying for education
- Responsible borrowing allows you to build a stronger credit history

Costs of Borrowing

- Make your borrowing fit your budget by understanding what your loan will cost
    - How are payments calculated?
    - How are interest rates set?
    - What fees may apply?
    - Is collateral required?
    - When will the loan be paid off?
- Repay loans as soon as your budget allows, to lower your cost of borrowing. Low monthly payments could mean higher borrowing costs. Remember that I=P x R x T. Costs of borrowing depend on three things: amount borrowed, interest rate and time it takes to repay.

Re-Payment Methods

- Installment Loans
    - You pay back in regular payments over a specified period of time
    - Each payment includes a predetermined portion of the principal plus the interest due
    - You apply for the amount of money you need and if approved you receive the full amount at one time, when the final payment is made the loan is considered repaid
    - If you need to borrow more, you may need to complete another application
- Revolving Loans
    - Also called a line of credit
    - Lender establishes a maximum amount you can borrow, called a credit limit
    - You don't have to borrow the full amount, you can borrow amounts as you need to, up to the limit
    - Payments are due based on the amount you borrow, not your limit
        - Credit cards are a form of revolving credit where payments can be either in full or in monthly installments Charge cards, however, allow you to make purchases but you must pay the full amount you owe each billing period

Interest and Fees

- Interest is the percentage rate that is multiplied by the unpaid loan balance to calculate the amount, in dollars, that you pay as one of the costs of borrowing
- Fixed Interest Rate - The interest rate remains the same over the life of the loan
- Variable Interest Rate
  - The interest rate can vary at certain points within the term of the loan
  - Monthly payments can change
  - Interest rates rise and fall which means that payments can get lower at some points in time, but also get higher
- Possible Fees
  - Application fees
  - Annual fees
  - Maintenance fees
  - Payment Processing fees
  - Over-limit fees
  - Returned Check fees
  - Late Payment fees
  - Balance Transfer fees
  - Cash Advance fees
- Annual Percentage Rate (APR)
  - The percentage of the loan principal that represents the total cost of borrowing for one year.
  - APR includes interest and certain fees
  - A loan's APR may be higher than its interest rate
  - **Beware of bundling additional costs into a loan when comparing loans, look at both APR and interest rate**

Collateral

- Secured Loan
  - The lender requires you to provide something of value as collateral to back up your promise to repay.
  - If you default, or fail to pay, the lender can take the collateral and use its value to offset what you owe
  - Car loans and home equity loans are examples of secured loans where the car or home is the collateral
  - Secured loans often have lower interest rates than unsecured loans
- Unsecured Loan
  - Do not require collateral
  - Lenders charge a higher interest rate because they are taking a greater risk of losing money if you default
  - Student loans and credit cards are examples of unsecured loans

Qualifying to Borrow

- What lenders want
  - ♦ Lenders evaluate a borrower's potential through a process called "underwriting"
  - ♦ Lenders grant loans and charge rates based on three specific areas
    - ▪ Credit
      - Your history of repaying previous loans
      - Your credit score
      - Your credit report
    - ▪ Capacity
      - Are you able to take on and pay additional debt, including the loan you are applying for?
      - Current income and employment
      - Debt to income ratio
    - ▪ Collateral
      - Anything of value that may be used to secure the loan
- Credit Risk
  - ♦ A borrower's potential for nonpayment
  - ♦ Lenders tend to offer loans with higher interest rates or may not approve loans at all
  - ♦ A borrower may be considered a high credit risk because of:
    - ▪ Lower credit score due to, among many things, paying bills late, having too much debt, previous bankruptcies, etc.
    - ▪ Not enough income to support the loan being requested in addition to current debts and expenses
    - ▪ Insufficient length of employment, or employment in an unstable industry
    - ▪ Not enough collateral to provide as security against the loan