UNIT 31 : SUPPORT MATERIAL

LOANS AND CREDIT

To Borrow or not to Borrow?

There are considerably different opinions held over this issue. Listed here are some pros and cons for taking out a loan.

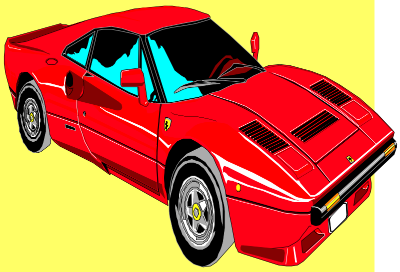
For

- You will be able to have goods, holidays, etc. immediately which you could not have without saving for many years.

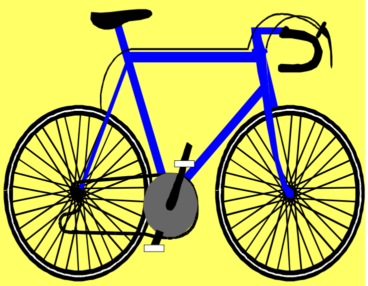
- Taking out a loan to buy something strategic like a home or a business may be the only possible root to obtain these as the income or savings they generate will eventually pay for them.

Against

- In nearly all circumstances taking out a loan or buying something on hire purchase will mean that you will have to pay considerably more for the item.



- Essentially taking out loans means that you are paying for today with the income from tomorrow. This is fine until you no longer have enough future income to pay for the loans and to live on at the time.



Balance

There is a need to strike a balance between obtaining what you want and what you can afford. There are clearly some items such as a home where you have a choice of paying rent or a mortgage and so you will be paying out money for accommodation whether you rent or buy. In general it would be sensible to estimate how much of your income you need to live on. You should ensure that repayments on loans never becomes so large that you have insufficient to live on.

Types of personal loan

- **A secured loan** is where the lender (which could be a bank, building society, credit card,hire purchase, store card etc.) has ownership of something of equivalent value until the borrower has paid off the debit in full. In such cases the interest rate charged for the loan is relatively low but if the borrower defaults on their payments the the lender has the right to sell the object offered in security to recover the remaining debt. The most common form of secured loan is called a mortgage for house purchase. The lender will keep the deeds of the house until the debt is cleared. If the borrower is in default on mortgage payments the house can be sold and the remaining debit cleared.

- **An unsecured loan** has more expensive interest rates than the secured loan as the lender has no way of recovering a debt of the lender defaults. Clearly the lender has to make more profit in this case to cover any losses from bad debts. The borrower would be very ill advised to undertake any debt that cannot be afforded. If they do default on one debt they will find it very hard to enter into any further loans or other financial transactions. All credit transactions are recorded on central databases which are available for all credit companies to inspect.

Ways of borrowing money

Lots of different businesses will want to lend you money. This is because it is extremely profitable for them. Beware of what you are entering into and look carefully at the different interest rates on offer. Here are some different sources of loans.

Bank Loan

Banks are a traditional source of loans both secured and unsecured. They are commercial institutions who exist to make money for their shareholders. They usually do this by charging a higher rate of interest in the longer term.

They offer both personal and business loans. For many people starting out in business a bank is often the only option. Often to provide the bank with security on a business loan a second mortgage is taken out against the value of a home. This is very dangerous as if the business fails you will be homeless.

Building Societies

A Building society is a mutual society which is owned by its borrowers and savers, so does not have to make profits for shareholders. In general it is usually cheaper to take out a large long term loan for a house with a building society however rates vary widely so you should look carefully. Although traditionally building societies would only lend money for housing today they are much more willing to offer loans for other purposes(e.g. unsecured loans for cars etc.)

Credit Cards

It is important to distinguish between credit cards and debit cards. A debit card (e.g. switch) will simply take an amount from your account in the same way as a cheque. You are not able to spend money that is not already in the account it draws on unless you have a loan agreement (overdraft) with the bank. A credit card can be used in a very similar way. You will be sent a bill within approximately 6 weeks of incurring the debt and if you have enough money to pay it all off immediately you will not be charged any interest. If however you do not have enough to pay you will only have to pay the minimum charge. However each month interest will be added to the bill based in what you owed from last month. In general credit cards are a very expensive way of borrowing money and it is almost always better to arrange a proper loan than to use a credit card as a means of borrowing large amounts for any length of time.

Credit cards are however a very useful way of paying bills and insure your purchase. This is very useful if using mail order as you can claim back you money if the goods do not arrive, or are damaged.

Hire Purchase and Store Cards

A supplier of certain goods will often enter into a hire purchase agreement with a buyer to pay back a certain amount each month rather than paying the full amount immediately. This can be very convenient but you will ultimately pay considerably more for the item. An alternative method is to delay purchase and pay a regular amount into a savings account. Not only will you pay the smaller amount but you will get the interest in the money while you are saving rather than paying interest on a loan.

A store card is just a way of allowing you to purchase an item on credit without entering into separate agreements for each item. It is good for the store as they make more from you and you are usually tempted to do more shopping in the store for which you might have cards.