Educational Program 2

All the forms of Credit Available to You

1. Credit Cards
    a. This is by far the most common form of credit available in the USA today. In fact, the average American has 4 credit cards.
    b. There are two main types of cards, secured and unsecured
        i. Unsecured credit cards are ones not backed up by any property or asset by the consumer. These are the most common, and tend to have lower interest rates and less fees associated with them. However, many of them tempt users into spending more than they should.
        ii. Introductory low rates entice people to enroll and spend more than they should until the rate goes up, and the consumer realizes he can't afford the monthly payments anymore. There are cards that offer reward programs, but this is just another way for creditors to entice people to spend more than they should.
        iii. Many consumers think that as long as they pay off their balances each year that credit cards have no negative affect on them. However, studies have shown that consumers who pay with credit instead of cash spend on average 30% more than they otherwise would. This happens because it is very convenient to just charge an item as it is instant gratification with a delayed cost.
        iv. Secured credit cards on the other hand have an asset or item that backs up the card. These tend to have higher rates, membership fees, and are usually meant for people trying to reestablish their credit after a bankruptcy or similar financial hardship. The credit limit on these is limited by the asset securing the card, which is helpful to consumers who have had problems in the past responsibly charging items to their credit cards.
2. Installment Debt
    a. This type of credit refers to any debt where the debtor makes regular payments to a creditor for longer than 10 months that cover the principal owed as well as any interest that accumulates. This allows for people to purchase items that would otherwise not be affordable to them. However, it also means that the final cost of the item purchased is much higher than it would have been had the item been purchased with cash. These types of loans can be used to purchase cars, electronics, even recreational vehicles
    b. Another form of an installment loan is a lease typically associated with vehicles. There are two types of leases, closed and open ended.
        i. Closed-end leases charge you a monthly payment for a set period of time with the option of walking away from the car or purchasing it for a set amount of cash. These usually have restrictive mileage limits on them which can lead to higher costs than first anticipated.
        ii. Open-end leases force a consumer to purchase the vehicle at the end, making this a more ideal option for people who know they will go over the mileage limits.
        iii. The problem with leases however is that you are paying a monthly fee for no ownership in the item, so you are basically renting the car for the time period agreed upon. Therefore, we do not support the idea of individuals leasing cars. All it does again is allow them to get a vehicle that otherwise they could not afford.
3. Home Mortgages
    a. Mortgages are the number one destroyer of wealth in America because they are not used responsibly. Mortgages used to be straightforward with a fixed rate loan over either a 15 or 30-year period. However, in recent times lenders have created instruments that give the illusion of short term benefits while generally harming consumers in the long run.

b. The first type is the conventional home mortgage. These have fixed monthly payments as the interest rate is fixed for the life of the term, which now includes 10, 15, 20, and 30-year terms. It is important to note that getting a 15 instead of a 30-year loan does not double your monthly payment, in fact it only rises by about 40%. So a $1,000 monthly payment would be $1,400 for 15 years but it would save you $108,000 over the life of the mortgage. This is the best option for purchasing a home as it has very little risk involved, as long as you can afford the monthly payments, you can buy a house. The next three options all carry considerably more risk and were created so Americans could live in homes that they realistically couldn't afford on normal terms.
c. Adjustable rate mortgages are exactly what they sound like; the interest rate can fluctuate over the life of a loan. The rate is pegged to an index, which rises and falls depending on macro-economic circumstances in the country. They were first created to allow consumers to buy a home that wouldn't be affordable with a fixed rate. The idea was that over time the income of the debtor would rise and he could afford more each month in case the rate went up. What this does however is leave you at the mercy of the economy. If the rate goes up, you have to pay more each month, even if you did not increase your income. This was a huge reason why so many people defaulted on loans during the housing bubble. They had ARM's, the rates went up, and they couldn't afford the payments anymore. We do not recommend this type of loan for most consumers.
d. Another type of mortgage is called a balloon mortgage. They are short term loans with features of fixed rate ones. They are typically 5 to 7 years in length and have a fixed monthly payment. However, the loan is obviously not paid off after this term, at which point the consumer has to refinance the rest of the balance owed, which is usually a big majority of it. Again, the interest rate on the loan is lower than it would be on a 30-year fixed rate and thus it allows people to get into a home that they otherwise cannot afford. It's just another way for creditors to make money while the consumer really does not benefit.
e. The next two types are the most obvious ones when it comes to getting people mortgages that they couldn't afford with a regular mortgage. An interest only loan is one where for the entire term of the loan you do not make any payments to the principal amount. So, basically you are renting the house while paying taxes and maintenance expenses. This couldn't be a worse option for consumers, and yet thousands took these loans. The simple question is why? These loans were created on the basis of ever appreciating home values in the early period of the 21st century. Home buyers bought the home, hoped for appreciation, and then sold the house at a profit. What this did was create a huge housing bubble similar to the internet stock bubble of the late 90's. Once the bubble burst and values dropped, consumers were left out t fend for themselves. They had no equity, and were paying thousands of dollars a month to "rent" their home. The second type is a negative amortizing loan. These loans charge homeowners less than the interest amount owed each month. The difference is added onto the principal amount each month, which in effect means that consumers owe more on their loan each month. This is a huge reason for the 2008 credit crisis. People lost their jobs, couldn't afford the payments anymore, and defaulted on the loans on a national scale. Millions of loans defaulted, and the economy went into a nosedive.

4. Home Equity Loans
    a. Because many people have some equity in their homes creditors have devised ways of giving you access to this money while also making a tidy profit for themselves.
    b. A home equity loan is basically a line of credit that the bank gives you that is secured by a second mortgage on your home. It has been advertised as an easy and affordable way to pay for home improvements and luxury items such as RV's, cars, or boats. It is marketed at people who can't save up for luxuries but instead need the instant gratification that a home equity loan can provide.
5. Student Loans
    a. There are many types of student loans, but the two broad categories they involve are federal and private student loans.

        i. Federal Loans are the single largest source of student loans and have to usually be paid back within 10 years of leaving school. They also tend to have lower interest rates and better terms than private loans.
        ii. Private loans are issued by universities or banks that work with them to make sure students can afford to go to school. These loans have a variety of payment lengths. They usually also have higher interest rates compared to federal loans.

6. Home Equity Line of Credit
    a. Another tool created by creditors to use up wealth contained in your home is Home Equity Line of Credit. It is basically treated like a credit card secured by the equity in your home. You are given a credit limit based on this amount, and can then spend how you wish each month. The interest payments are based on a preset rate usually and do not change, unless it is a variable rate.
    b. This, like the other examples above is just another way for people to ruin their future by purchasing items they can't afford in the present. It takes a disciplined person to say no to instant gratification. If you want an item, save up for it and save the thousands of dollars in interest you will end up paying using a HELOC.
7. Consolidation Loans
    a. A consolidation loan is any loan that is used to pay off other bills with higher interest rates. The most common form is the home equity loan. People take this loan, secured by your home, and use it to pay off their high interest credit card bills.
    b. If you use the savings achieved by doing this to pay down your other debt, then this is a good option for some people. As before, this takes a very disciplined consumer which sadly most of us are not. If you consolidate all your payments into one loan and then continue spending the savings on luxuries, you will quickly be faced with mounting levels of debt. The only difference now is that your debt is secured. This means you can lose your house now if you default on the loan, something unsecured loans cannot do.