ACEE ARIZONA COUNCIL ON ECONOMIC EDUCATION

WHAT IS CREDIT?

RECOMMENDED GRADE LEVELS	AVERAGE TIME TO COMPLETE	ARIZONA STANDARDS
9-12	**Anticipatory Set & Facilitation**: 45 minutes **Conclusion/Assessment Options**: 10 -120 minutes	HS.E1.3 Evaluate the cost and benefits of using credit.

LESSON PLAN OBJECTIVES
Upon completion of this lesson, students will be able to: ▪ identify and explain the meaning of key terms such as credit, interest and risk ▪ explain the advantages and disadvantages of using credit ▪ identify types of financial institutions that offer credit ▪ explain that most credit transactions are voluntary ones in which both sides expect to gain

MATERIALS		
MATERIALS PROVIDED IN THIS LESSON PLAN	MATERIALS SPECIFIC TO THIS LESSON PLAN BUT AVAILABLE AS A SEPARATE DOWNLOAD	MATERIALS TO ACQUIRE SEPARATELY DEPENDING ON OPTIONS TAUGHT
▪ Credit Exercise 1: What is Credit?, one copy per student ▪ Credit Exercise 2: Common Forms of Credit, one copy per student	None	None

RESOURCES
EXTERNAL RESOURCES
External resources referenced in this lesson plan: ▪ https://econedlink.org/resources/buying-on-credit-video-and-quiz/

LESSON FACILITATION

VOCABULARY ACTIVITY

Brainstorming Web

Approximate time: 10 minutes

This activity is designed to encourage thinking about prior credit knowledge that may or may not be accurate, with the opportunity to then discuss misperceptions during the activity and lesson instruction.

1. Put the students in groups of 3-4. Provide each group with a black piece of paper.
2. Have the students draw a circle in middle of the paper and write the word credit in it.
3. Tell the students that they have 5 minutes to draw a web of words or phrases that they think explain what credit is.
4. At the end of the 5 minutes, have the groups share out the words/phrases that they wrote down. Correct any misconceptions that come up during the share out.

ANTICIPATORY SET

What is Credit?

Approximate time: 10 minutes

1. Ask students "Does anybody use credit to pay for things?" Briefly discuss their answers and explain that understanding credit will help them make better decisions now and in the future.
2. Ask students" When does it make sense to use credit?" Stress the point that decisions about using credit are similar to other decisions people make. Therefore, it is important to understand both the advantages and disadvantages of using credit.
3. Tell students they will view a video about credit. As they view the video, they should listen to determine the types of credit, as well as the advantages and disadvantages of credit.
4. Show the EconEdlink video at https://econedlink.org/resources/buying-on-credit-video-and-quiz/. After students have viewed the video, ask them the following questions:
   - What are the three main types of credit?
     (Installment, revolving and open.)
   - What should you try to avoid when using credit?
     (You should try to avoid paying back only the minimum monthly payment.)
   - What are the benefits of using credit?
     (Credit allows you to purchase goods and services and pay for them later.)
   - Why do creditors look at your credit history and credit scores?
     (These show how likely you are to repay your loans.)

RECOMMENDED FACILITATION

Approximate time: 25minutes

Materials to prepare:

- One copy of **Credit Exercise 1: What is Credit?** per student
- One copy of **Credit Exercise 2: Common Forms of Credit** per student

Give each student a copy of **Credit Exercise 1: What is Credit?** Ask students to read this exercise and answer the questions at the end. When they have finished, discuss the answers. Below are suggested answers:

a. Why use credit? (Credit allows people to obtain the use of money that they do not have. In return, people who use credit repay the amount they borrow, plus interest.)

b. What are the advantages of using credit? (Credit can help people in many ways- by enabling them to acquire valuable assets, or by helping out with emergency expenses.)

c. What are the disadvantages of using credit? (Goods and services can cost more when purchased on credit. When people buy things on credit, the interest and fees they must pay amount to a deduction from the money they might otherwise use to buy things they currently want. Also, people sometimes borrow too much. That is, they use too much credit in relationship to their income. When people are overextended and making heavy credit payments, they have less money left to pay for food, transportation, clothing, and other bills. Items bought on credit can be repossessed (taken back) by the lender if borrowers are unable to make the required payments.)

d. What institutions provide credit? (Commercial banks, savings and loans, credit unions, and consumer finance companies. Utilities and medical providers extend service credit.)

e. What is interest? (Interest is the price paid for using someone else's money.)

f. Who most often wins in a credit transaction? (Ordinarily, both parties expect to benefit from a credit transaction. Borrowers are able to purchase something that may be of value today and/or in the future. Lenders are repaid the money they lent, plus interest and sometimes fees.)

g. How does risk influence the rate of interest? (As risk goes up, interest rates usually go up too. Higher-risk loans usually result in higher interest rates. Lower-risk loans result in lower interest rates.)

h. What is an unsecured loan? (An unsecured loan is one that doesn't require collateral. It is granted based solely on the borrower's creditworthiness.)

i. What is collateral? (Collateral is an asset used to back a loan. For example, a car loan is backed by the car that is being purchased. If you fail to repay your loan, the lender can repossess the car and sell it to pay off the loan. If there is still a balance owed after the sale of the col- lateral, the borrower will be expected to pay off this remaining balance. Loans that require collateral are called secured loans.)

Give each student a copy of **Credit Exercise 2: Common Forms of Credit**. Ask the students to follow along as you explain the types of credit found in the table, as well as the advantages and disadvantages of each. Make sure that the students understand the key characteristics of the lending institutions identified in the table. These characteristics include the following:

- Commercial banks and savings and loans are very similar in the types of financial services they provide their customers; these include loans, savings accounts, and checking accounts.
- Credit unions are not-for-profit cooperatives- enterprises owned by their members-that provide many of the same financial services as commercial banks and savings and loans.
- Mortgage companies are specialized firms that make residential and commercial loans, often selling them to other lenders.
- Consumer finance companies lend money to individuals (and sometimes businesses) for the purchase of things such as automobiles or household appliances. Sometimes their customers do not qualify for bank credit and therefore pay a higher rate of interest.
- Department stores and other financial service providers sometimes offer their own credit cards for their customers' use.

Ask the students to answer the questions at the end of **Credit Exercise 2: Common Forms of Credit**. When they have finished, discuss the answers.

a. What are the advantages of home loans and college loans compared to credit cards and personal loans? (Home and college loans usually help people acquire assets that increase in value. Interest rates on these loans are usually lower than the rates for credit cards or personal loans.)

b. What are the disadvantages of credit cards and college loans? (Sometimes young people borrow more than they should for college loans. Upon graduation, new graduates may have difficulty repaying the money they have borrowed. Sometimes young people overuse their credit cards. Credit card loans have relatively high interest rates, and large credit card balances therefore can be burdensome for long periods of time.)

c. Which of these categories would be considered secured loans and which would be considered unsecured loans? (Homes and cars would be secured; college, personal and credit cards would be unsecured.)

CONCLUSION OPTION

<u>What is Credit?</u>

<u>Approximate time</u>: 10 minutes

Use the following questions to review the lesson.

- What is a key advantage of using credit? *(Using credit allows* you to *obtain goods or services today and pay for them later; using credit* can *help people acquire valuable assets-like a college education or a home;* using *credit* can *also add* to *the* enjoyment of *life.)*

- What is a key disadvantage of using credit? *(When credit is easily available,* some *people borrow and spend more* money *than they should. Loans have* to *be repaid; lenders charge interest for the* use of *their* money; *individuals who borrow heavily have* to *give up* some *things they would like* to *have today because they are required* to *pay for goods or services they have already* consumed.*)*
- Who gains from credit transactions? *(Both sides in a credit transaction expect* to *benefit. Borrowers are able* to *purchase* some- *thing that* may *be* of *value today and/or in the future. Lenders are repaid the* money *that they lent, plus interest and* sometimes *fees.)*

ASSESSMENT

Assessment Project

Approximate time: 60 - 120 minutes

Assign the students to prepare a collage or brochure outlining their planned use of credit over the next 10 years. Have them include the answers to the following questions within their work.

- What do you plan to buy with credit over the next 10 years?
- What institutions will you use to obtain credit?
- What are the advantages of using credit? Disadvantages?
- What advice would you give to a peer about using credit?

Credit Vocabulary

	TERM	DEFINITION
1	Credit	An amount of money that a financial institution lends or makes available to a client, to be repaid typically in monthly installments including interest.
2	Interest	A sum paid or charged for the use of money or for borrowing money.
3	Risk	Exposure to the chance of injury or loss. A hazard or dangerous chance.
4	Return	The gain realized on an exchange of goods.

Credit Exercise 1: What is Credit?

	Total Points Earned
45	Total Points Possible
	Percentage

Name ____________________

Date ____________________

Class ____________________

What is Credit?

Credit allows people to obtain the use of money that they do not have. To obtain credit, a prospective borrower must convince someone else (a lender) to provide a loan in return for the borrower's promise to pay the money back, plus an additional charge called interest. People obtain loans to buy cars, homes, and major appliances, to improve their homes, to pay for college education, and so forth.

Credit decisions-whether to borrow money, and for what reasons-can be difficult. Like all difficult decisions, credit decisions involve examining the advantages and disadvantages facing the individual making the choice. The hard part, of course, is figuring out whether the advantages of using credit outweigh the disadvantages.

There are many advantages to using credit. Credit can help people acquire assets. Assets are goods or services that usually retain or increase their value. Ordinarily, a home or post-secondary education is considered an asset. Credit also can help people lead happier lives by enabling them to obtain the goods and services they wish to have now while paying for them in the future. And credit can help people in an emergency.

There are also disadvantages to using credit. Some people make the mistake of using too much credit in relation to their income; they may then incur heavy burdens of debt from which it is difficult to recover. Many new college graduates, for example, spend a lot of the income from their first jobs repaying large credit card debts they have taken on while in college. As they spend a great deal of their current income paying for previous purchases, they are left with less money to buy things they would like to have in the present. And if they miss payments or default on loans altogether, they may face serious negative consequences, including the inability to get credit at a later time when it would otherwise make sense to borrow money for a major purchase.

Financial institutions (commercial banks, savings and loans, credit unions, and consumer finance companies) hold money that they, in turn, lend out to others. The owners of financial institutions expect to be compensated when they make a loan. This compensation is called interest. Interest is the price a borrower pays to a lender for use of the credit provided by the lender. Interest is the reward lenders receive for allowing others to use their funds.

Both sides in a credit transaction expect to benefit. Borrowers are able to purchase something that may be of value to them today and/or in the future. Lenders are repaid the money that they lent, plus interest.

An important factor in determining the rate of interest to be charged is the amount of confidence the lender has that the amount of the loan, plus interest, will be repaid in the agreed-upon time. Higher- risk loans-loans where it is uncertain that the borrower can repay-usually result in higher interest rates. Lower-risk loans-loans where it seems evident that the borrower can repay-usually result in lower interest rates.

A loan for an intangible item, like a vacation, is likely to cost more in interest than a loan for a tangible item, like a home. Secured loans (those that are backed by other assets, like your home or your car), are likely to have lower interest rates than unsecured loans (those that are not backed by other assets). An asset used to back a loan is called collateral. For example, a car loan is backed by the car that is being purchased. If you fail to repay the loan, the lender can repossess (take back) the car and sell it to pay off the loan. If there is still a balance owed after the sale of collateral, the borrower will be expected to pay off this remaining balance.

Questions

a. Why use credit?

b. What are the advantages of using credit?

c. What are the disadvantages of using credit?

d. What institutions provide credit?

e. What is interest?

f. Who most often wins in a credit transaction?

g. How does risk influence the rate of interest?

h. What is an unsecured loan?

i. What is collateral?

Credit Exercise 2: Common Forms of Credit

	Total Points Earned
30	Total Points Possible
	Percentage

Name ____________________

Date ____________________

Class ____________________

Common Forms of Credit

Types of Credit	Lender	Advantages	Disadvantages
Home Mortgage	• Commercial bank • Savings and loan • Credit union • Mortgage Company	• Homes can increase in value. • Interest rates for mart-gage are relatively low. • The interest paid is tax-deductible.	• Mortgages are usually long-term commitments. • Obtaining a home loan involves extensive credit checks.
Car Loan	• Commercial bank • Savings and loan • Credit union • Consumer finance company	• Cars can make it easier to work and earn an income.	• Cars lose their value relatively quickly. The car you purchase on credit may have little value when the last payment is made.
College Loan	• Commercial bank • Credit union • Savings and loan	• A college education is usually a good investment.	• Students sometimes borrow more than is necessary. • New graduates can face difficulty in repaying large loans.
Personal Loan	• Commercial bank • Savings and loan • Credit union • Consumer finance company	• Personal loans allow individuals to purchase today that boat or vacation they want, for example.	• Personal loans have relatively high interest rates. • Some people may borrow more than their income should allow.
Credit Card	• Commercial bank • Savings and loan • Department stores • Other financial institutions • Credit union	• Credit cards are convenient to use and useful in an emergency. • Credit cards provide a record of charges.	• Credit cards may have relatively high interest rates. • Some card holders may borrow more than their income should allow.

Questions

a. What are the advantages of home loans and college loans compared to credit cards and personal loans?

b. What are the disadvantages of credit cards and college loans?

c. Which of these categories would be considered secured loans and which would be considered unsecured loans?