

Reasons for a Loan

Name: _____ () Class: _____ Date: _____

Objectives:

- Understand how to deal with debt
- Understand the circumstances in which individual may need to borrow money

Activity 1

Good debt?

Divide the class into groups of 3 to 4 students and guide them to discuss which case has the greatest need to get a loan. Everyone should take on the role to debate and make arguments in support of their borrowings. At the end, ask each group to explain whether their case's debt is good or bad.

The people in the following cases are planning to borrow money for different reasons. Think about which case has an actual need to get a loan, and provide supporting reasons for your decision. Then, discuss with classmates in groups. The teacher will then assign a case to each group and a student will need to explain whether the debt is good or bad.

 <p>I need a large amount of money to pay for the tuition fee for my university degree.</p>	<p>Yes. University tuition fees are expensive. Students with financial needs can apply for student loans to pay for the tuition fees, but they must consider their repayment ability.</p> <p>or</p> <p>No. If your family has sufficient financial resources to pay for the tuition fees, you do not need to apply for the loan in order to avoid interest repayment.</p>
 <p>The stock market is now blooming. I want to invest in stocks but I do not have enough savings. Therefore, I plan to borrow money and use it to invest.</p>	<p>No. The risk of borrowing to invest is quite high. Although there may be returns on the investment, you may also suffer losses as well. At the same time you also need to pay interest on the loans.</p>
 <p>I am an entrepreneur and I am planning to borrow money to buy a van to deliver goods.</p>	<p>Yes. Buying a van may help increase the sales for entrepreneurs, but he must also evaluate his repayment ability.</p> <p>or</p> <p>No. Borrowing will increase the operating costs of his business and he also needs to pay interest for the loan. He can consider renting a van to run the business.</p>
 <p>I would like to buy a new mobile phone, but my parents do not give me enough pocket money. I intend to borrow money to buy it.</p>	<p>No. Borrowing money to buy consumer goods that are "wants" instead of "needs" will lead to an increase in debt, and even result in overspending and a reduction of wealth.</p>

1. Is borrowing money free? What costs does it include? What are the responsibilities of the borrower?

No. The borrower must reserve money to repay the principal and interest on a regular basis. Some loans come with very high interest rates and some may charge a handling fee. Some financial institutions may even require the borrower to provide some assets as collateral (security).

The responsibilities of the borrower include repaying loans on time and maintaining a good credit record.

Notes: Comparison of different ways to borrow money

2. What are the consequences of late repayment?

Late repayments will be fined, which will increase the financial burden of the borrower. The individual's credit score will drop, affecting future loan applications. If the debt is eventually unable to be repaid, the collateral will be seized and the borrower may face bankruptcy.

Activity 2

Matching different sources of borrowing

	Application terms	Loan amount	Interest	Repayment period
Credit card spending	Easiest	Lowest	High (assuming only minimum payment is made)	Short
Mortgage loans	Most difficult	Highest	Floating rate (adjusted according to rate increase or reduction cycle) Lowest (with collateral)	Long
Personal loans	Medium	Medium	Based on an individual's credit score. Generally speaking, the interest is 60% or below	Medium
Credit card cash advances	Medium	Medium	Highest	Short

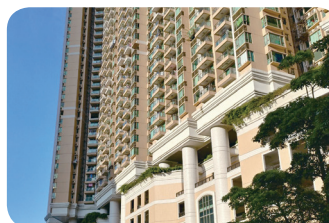
Read the information about the following types of borrowing (credit cards, personal loans, mortgage, cash advances). Discuss which type of loan(s) can be used in the following situations and list the reasons. Can you think of alternative actions to borrowing? If so, describe and explain them. Then discuss with classmates in your group.

Credit card spending



It is a non-cash payment method. The cardholder does not need to pay cash when purchasing with the credit card. Repayment is needed before the due date on the statement.

Mortgage



It is an act of providing some private asset as a guarantee for a debt.

Personal loan



A loan issued by a bank or financial institution to a borrower for personal consumption or other use.

Credit card cash advances



Financial institutions allow its account holders to withdraw within the pre-agreed limit.

Divide students into groups of four and guide them to read about different types of borrowing (credit cards, personal loans, mortgage loans, cash advances). Then discuss which type of borrowing can be used in the following situations and list the reasons. In addition to borrowing, ask students to think of alternative actions to borrowing, and they can further describe and explain. Upon discussion, each group sends a representative to explain the reasons for such pairing.

Situation 1: Interested in buying a 500sq ft private residential flat, already has sufficient money for the down payment



Suitable way(s) of borrowing: **mortgage**

Reason:

The amount for buying a flat is large. Most people cannot make a one-off payment, so borrowing is needed.

Situation 2: A family member has been injured in a car accident and urgently needs a large amount of money for surgery



Suitable ways of borrowing: **cash advances, credit cards, personal loans, borrowing from relatives or friends, or no need to borrow**

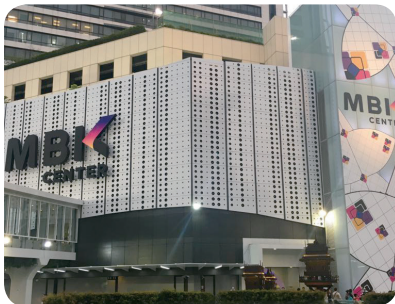
Reason:

Borrowing is the only viable option if a family member is in urgent need of money and does not have insurance or emergency funds.

Or

Borrowing is not needed if there are sufficient savings to cover the surgery cost, medical insurance has been purchased, medical fee subsidy is provided by public hospital, or subsidy from the Community Care Fund has been approved.

Situation 3: A family travels to Thailand for a four-day holiday and needs to pay for the hotel fee and shopping



Suitable way(s) of borrowing: **credit cards or no need to borrow**

Reason:

As the cost involved in travelling is not high, it can be paid with credit cards. Moreover, if the amount can be repaid on time, credit card interest is lower and bonus points can be earned.

Or

If the savings are sufficient to cover travelling costs or the whole family shares the expenses, borrowing is not needed. If you cannot afford the travelling costs, shortening the trip or changing the destination can be considered.

Situation 4: Lost all cash while travelling, and the use of credit card is not popular in the travelling country



Suitable way(s) of borrowing: **cash advances**

Reason:

A cash advance is the only viable option because it is not possible to pay with credit cards and there is an urgent need of money when travelling abroad. However, even the bank accepts the cash advance withdrawal, the borrower will have to pay the bank handling fees and interests afterwards.

1. Give an example of a good debt and a bad debt respectively.

	Good debt	Bad debt
Example	Any reasonable answers. Examples: Buying a flat, further studies	Any reasonable answers. Examples: gambling, purchasing luxury goods, travelling

Good debt means that it will not lead to excessive indebtedness. Sometimes proper and reasonable use of good debts can increase personal income and net assets. Bad debt means it will lead to uncontrolled excessive debt, and the borrower is unable to repay the principal and interest resulting in heavy debts.

Summary

- ◆ Avoid borrowing for non-necessary daily expenses.
- ◆ Understand borrowing comes with costs, such as additional interest.
- ◆ Only borrow what you need and when you can repay.
- ◆ Understand different types of borrowing (including credit cards, personal loans and mortgage loans). The borrower should adopt the most appropriate way of borrowing when there is a need.

Extension activity

The Annualised Percentage Rate (APR) is a reference rate which includes the basic interest and other related fees and charges (such as handling charges and service charges) charged on a loan (such as credit cards and personal loans). Collect data to complete the following table and compare the Annualised Percentage Rate for different loans.

	Credit card name	Personal loan name
	Example: Bank A credit card	Example: Car loan offered by Bank B, Tax loan offered by Bank C
	Credit card spending	Personal loans
Annualised Percentage Rate (%)		