# Short Term Loans ~~Exit Quiz~~ | MEL4E

Most of us borrow money at some time to finance the purchase of items we need to have now, but cannot afford to pay in full. Homes, cars, student loans are common things that might be considered essential. Loans may be necessary for any of these things.

However, we often borrow money for small purchases. Or we may need money for emergencies that come up (car repairs, lost job, etc.). Today we will talk about 3 options for borrowing:

- Lines of Credit
- Credit Cards
- Payday Loans

**Lines of Credit:** An arrangement between a financial institution, usually a bank, and a customer that establishes a maximum loan balance that the lender permits the borrower to access or maintain.

Notes:

- Lines of credit are flexible and accessible.
- Lines of credit have interest rates only slightly higher than mortgage rates.
- Because of these advantages, you must meet certain conditions to get one.

Example: Colin needed to make some emergency car repairs, and borrowed $2,000 on his line of credit. To repay the loan, he will make monthly payments for 1 year. He is charged interest at 1.5%, compounded monthly.

a) Fill in N, I(%), PV, PpY, and CpY

b) How much is Colin's monthly payment (Pmt)?

$168.02 per month.

| | |
|---|---|
| N: | 12 (payments) |
| I(%): | 1.5 |
| PV: | 2000 |
| Pmt | −168.02 |
| FV: | 0 |
| PpY: | 12 |
| CpY: | 12 |

**Credit Cards:**

| Pros: | Cons: |
|---|---|
| - Convenience<br>- Rewards<br>- You can build a good credit score | - High interest rates<br>- Dangerous if you cant control your spending |

Example: Janelle purchased a pair of boots for $100 on her credit card. Her card charges her 18% interest compounded monthly, and her minimum payment is $10. Janelle figures she will just make the minimum payment until they are paid off.

a) Fill in I(%), PV, Pmt, and PpY, and CpY

b) How many months will it take Janelle to pay off the boots?

It takes 11 months

| | |
|---|---|
| N: | 11 (payments) |
| I(%): | 18 |
| PV: | 100 |
| Pmt: | -10 |
| FV: | 0 |
| PpY: | 12 |
| CpY: | 12 |

c) How much did Janelle pay for the boots in total?

11 payments of $10

= $110

d) How much interest did the credit card company make off of Janelle?

$110 - 100 = $10 in interest.

**Payday Loans:** A loan with a private lender, where you borrow a small amount (usually a few hundred dollars) and agree to pay it back when you get your next paycheque.

Example: A Money Mart in Guelph will lend you $300 for only $20. This means you pay back 1 single payment of $320 on your pay day (1 week from now). What is the effective interest rate you are being charged here? Use 52 for PpY and Cpy.

The effective interest rate is 347%.

| | |
|---|---|
| N: | 1 (payments) |
| I(%): | 347% |
| PV: | 300 |
| Pmt: | -320 |
| FV: | 0 |
| PpY: | 52 |
| CpY: | 52 |