

Making Credit Choices

LESSON DESCRIPTION AND BACKGROUND

In deciding whether to use credit, individuals must consider many factors. The considerations are often situation-specific and they are often subject to different interpretations by different prospective borrowers. The underlying question in each case is whether the advantages of using credit would outweigh the disadvantages. In this lesson, the students address that question in an examination of four hypothetical cases, acting as financial advisors to clients considering the use of credit.

Lesson 12 correlates with national standards for economics and personal finance as shown in Tables 1-2 in the introductory section of the publication.

ECONOMIC AND PERSONAL FINANCE CONCEPTS

- Credit

OBJECTIVES

At the end of this lesson, the student will be able to:

- Identify advantages and disadvantages of using **credit**.
- Make decisions about the wise use of credit.

TIME REQUIRED

One 45-minute class period

MATERIALS

- A copy for each student of **Exercise 12.1** from the *Student Workbook*

ADDITIONAL RESOURCES



To download visuals, find related lessons, correlations to state standards, interactives, and more visit <http://fffl.councilforeconed.org/9-12/lesson12>.

PROCEDURE

1. Tell the students that in this lesson they will practice making wise decisions about the use of credit. They will participate in an exercise to determine when the advantages of using credit outweigh the disadvantages.
2. Explain that the students are going to play the role of financial advisors. Give each student a copy of **Exercise 12.1** from the *Student Workbook*. Have the students read Part 1, Your Job.
3. Divide the class into small groups. Ask the students in each group to read the four situations described in Part 2. The groups should decide on the advantages of using credit, the disadvantages of using credit, and make a recommendation to each of their four clients.
4. After the students have read and discussed the cases of the clients, discuss their recommendations with the class.

Client 1

- a. What is the main advantage of getting credit in this case? (**The credit will be used to pay for a college education, which is a valuable asset. With this education, the client will begin earning income as a chemical engineer in four years.**)
- b. What is the main disadvantage of getting credit? (**The college loan is for a relatively large amount of money.**)
- c. Is the loan being used to purchase a valuable asset? (**Yes.**)
- d. Do you think the client is likely to be able to repay the loan? (**Yes.**)

- e. Do you recommend that this client apply for the loan? **(Yes. The college education sought by Client 1 will provide future benefits in terms of earning potential that outweigh the cost of using loans to help pay for school. It will be a good idea for Client 1 to try to identify loans with low interest rates to help her pay for school; she also should take advantage of any scholarship opportunities that might arise.)**

Client 2

- a. What is the main advantage of getting credit in this case? **(The television set will add enjoyment to everyday life.)**
- b. What is main disadvantage of getting credit? **(A television set is not a valuable asset, since it loses value very quickly. Also, in a short period of time, Client 2 will be moving into an apartment; the move may involve many unexpected expenses.)**
- c. Is the loan being used to purchase a valuable asset? **(The television set is an asset; however, its market value will decline over time.)**
- d. Do you think the client is likely to be able to repay the loan? **(Probably, although there are uncertainties related to future expenses.)**
- e. Do you recommend that this client apply for the loan? **(No. The television set sought by Client 2 will not maintain its value. Client 2 could buy a less expensive television set now, or wait to purchase a television set after the move to the apartment.)**

Client 3

- a. What is the main advantage of getting credit in this case? **(Fun with school friends before graduation.)**
- b. What is main disadvantage of getting credit? **(A vacation does not retain much value. Once the vacation is over, nothing is left but memories—and maybe a suntan. Using the credit card is an expensive way to pay for a vacation. It seems likely that Client 3**

will not be able to pay the credit card bill right away and so will have to pay a great deal of interest.)

- c. Is the loan being used to purchase a valuable asset? **(No.)**
- d. Do you think the client is likely to be able to repay the loan? **(Probably, although it may take him a while to repay the loan, which could make the interest expense of using credit fairly high.)**
- e. Do you recommend that this client apply for the loan? **(No. The vacation sought by Client 3 will not retain much value. It will be expensive in terms of credit card interest. In a short time, Client 3 will finish college and get a job. In the relatively near future, Client 3 will be much better able to afford a vacation.)**

Client 4

- a. What is the main advantage of getting credit in this case? **(Obtaining a car loan will help Client 4 arrive safely and promptly at work each day.)**
- b. What is main disadvantage of getting credit? **(The car loan, with interest, must be repaid. Also, new cars lose their value quickly.)**
- c. Is the loan being used to purchase a valuable asset? **(Yes, although it will diminish in value over time.)**
- d. Do you think the client is likely to be able to repay the loan? **(Yes, as long as the car purchased is not too expensive.)**
- e. Do you recommend that this client apply for the loan? **(Yes. Client 4 would be wise to obtain the car loan and buy the car. It is a good investment in the client's future earnings, and driving the new car will be a lot safer than driving the car the client has now. Client 4 may also wish to look at reliable used cars as an alternative.)**

CLOSURE

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 assets that retain or increase in value—like a college education or a home. Credit can also add to the enjoyment of life and help people in times of emergency.)
- What is a key disadvantage of using credit?
(When credit is easily available, some people spend more than they otherwise would. Loans have to be repaid. Lenders charge interest for the use of their money. Individuals have to sacrifice things they wish to have today because they are required to pay for their use of credit in the past.)

ASSESSMENT

As a homework assignment, ask the students, working individually, to act again as Sharp Financial Advisors by writing up a report for “The Case of the Eager Young Professionals.” In his or her report, each student should state a definite recommendation and explain the recommendation by reference to (1) the advantages and disadvantages of seeking credit in this case, (2) whether the couple is planning to purchase an asset, and (3) whether the couple is likely to repay the loan.

The Case of the Eager Young Professionals

We are a newly married couple. Both of us are 28 years old. We have a fashionable apartment with great furniture. The deck from our apartment overlooks a sumptuous swimming pool and the tennis courts. We have good jobs and good incomes. We are upwardly mobile professionals. In our professions, you are what you drive. Currently, we drive a stodgy, late-model car that has 75,000 miles on it. We want to look the part of prosperous young professionals. We are

thinking about buying a very nice luxury car with all the coolest features. We work hard. We deserve it. We will need to borrow about \$55,000 to buy this car. That may sound like a lot, but you haven't seen this car! Besides, the car dealer says we can afford the monthly payments.

Call on the students to report their recommendations. Discuss their recommendations by reference to the points below. Answers given in parentheses should be regarded as possibilities; other answers might also be defended as reasonable.

- What is the main advantage of getting credit in this case? **(Driving a great car and feeling prosperous.)**
- What is main disadvantage of getting credit? **(The car payments will be steep. In making these payments, the clients will have to give up other things they might want to have in the present, until the loan is paid off.)**
- Is the loan being used to purchase a valuable asset? **(A car is an asset, but cars lose much of their value quickly. Also, the clients already have a car. It seems that they want a new car less for the services it will provide and more for the status it will confer.)**
- Do you think the clients are likely to be able to repay the loan? **(Maybe not. This couple is showing some financially reckless behavior that suggests they may encounter some credit problems in the future.)**
- Do you recommend that these clients apply for the loan? **(No. The car is an asset that will lose its value quickly, and buying it would involve a large financial sacrifice for this couple. Driving the old car a while longer makes more sense. The couple should consider saving the money that would have gone into payments for a new car and putting that money toward a down payment on a new house instead. Houses usually increase in value, while cars usually do not. These clients will probably benefit**

more as owners of a new house than as owners of a new luxury car. While this may not sound like as much fun, it is good financial advice.)

EXTENSION

Invite a credit counselor or financial advisor to visit your class to discuss the advantages and disadvantages of using credit. Ask your guest to discuss some of the common problems he or she sees with young people who are using credit for the first time.