Lesson Description

This lesson uses a specific scenario to demonstrate how to apply the statistical and economic information in "Extra Credit: The Rise of Short-term Liabilities," the lead article in the fall 2008 issue of *Inside the Vault*. Students read a story that illustrates some of the trends and concerns discussed in the article. The facts of the story are then analyzed to identify the debt trap and to generate solutions to the problem. Using an online calculator, students calculate the amount of time it takes to pay off a credit card based on the monthly payment amount.

Grade Level

9-12

Concepts

Credit cards
Debt
Opportunity cost
Payday loans

Objectives

Students will:

- Identify changes over time in consumer debt.
- Identify trends in the credit market.
- Analyze income and expenses.
- Analyze the effects of debt.
- Identify ways to overcome debt problems.

Content Standards

National Personal Financial Literacy K-12

Planning and Money Management: Organize personal finances and use a budget to manage cash flow.

- **Standard 1:** Develop a plan for spending and saving.
  - Twelfth-grade expectation 4: Analyze how changes in circumstances can affect a personal budget.

Financial Responsibility and Decision Making: Apply reliable information and systematic decision making to personal financial decisions.

- **Standard 1:** Take responsibility for personal financial decisions.
  - Eighth-grade expectation 1: Identify ways to be a financially responsible young adult.
  - Twelfth-grade expectation 1: Explain how individuals demonstrate responsibility for financial well-being over a lifetime.
- **Standard 4:** Make financial decisions by systematically considering alternatives and consequences.
  - Eighth-grade expectation 4: Use a financial or online calculator to determine the cost of achieving a medium-term goal.
  - Eighth-grade expectation 3: Evaluate the results of a financial decision.
  - Twelfth-grade expectation 2: Use a financial or online calculator to determine the cost of achieving a long-term goal.

Credit and Debt: Maintain creditworthiness, borrow at favorable terms and manage debt.

- **Standard 1:** Identify the costs and benefits of various types of credit.
  - Twelfth-grade expectation 1: Compare the cost of borrowing $1,000 by means of different consumer credit options.
  - Twelfth-grade expectation 4: Using a financial or online calculator, compare the total cost of reducing a $1,000 credit card balance to zero minimum payments vs. above-minimum payments.
  - Eighth-grade expectation 6: Discuss the potential consequences of using "easy access" credit.
- **Standard 3:** Describe ways to avoid or correct credit problems.
  - Twelfth-grade expectation 1: Describe possible consequences of excessive debt.
  - Twelfth-grade expectation 2: List actions that a consumer could take to reduce or better manage excessive debt.

Time Required

180 - 210 minutes

Materials

Copies of Handouts 1 and 4 for each student
Copies of Handout 2 cut apart to provide one question strip for each student
A copy of Handout 2—Answer Key
A copy of Handout 3 for the teacher
Copies of Handout 5 cut apart to make one set of cards for each pair of students
Copies of Handouts 6, 7, 8, 9, 10 and 11 for each student
A copy of Handout 10—Answer Key for the teacher.
Copies of Visual 1 and Visual 1—Answer Key

A calculator for each pair of students
A soft sponge ball
Access to internet
Optional: small prizes for the winners of the vocabulary game

Procedures

1. Introduce the topic by asking students if they have seen advertisements for or heard about payday loans. *(Answers will vary.)* Ask students if they, their friends or family members use credit cards. *(Answers will vary.)* Tell students that during the next several class periods they are going to learn more about the use of short-term loans, such as payday loans, and the use of credit cards in the United States.

2. Distribute a copy of *Handout 1: Extra Credit—The Rise of Short-term Liabilities* from *Inside the Vault* to each student. Give each student one question strip from *Handout 2: Extra Credit Discussion Questions*.

3. Tell students that they will form groups based on the number listed on their question. All students with question one will work together, all students with question two will work together and so on. Members of each group will work together to answer their group's question and provide supporting evidence from the article. Every member of each group should record the answer and supporting information on paper and be prepared to share the group's findings. Allow approximately 20 minutes for the groups to prepare their reports.

4. Allow time for a 1- to 2-minute report from each of the seven groups. Presentations should include some of the content provided on *Handout 2: Extra Credit Discussion Questions—Answer Key.*

5. Tell students to skim the article again and circle vocabulary words important to understanding the content.

6. Instruct students to take out notebooks or notebook paper. Call on students to name content-specific vocabulary words from the article that were circled, and list the words on chart paper as they are given. Use *Handout 3: Vocabulary Definitions* to help students understand the meaning of each word. Tell students to record the terms and definitions in their notebooks as terms are defined.

7. Define opportunity cost as the highest-valued alternative that is given up when a choice is made. Explain that although this concept is not specifically mentioned in the article, it is very relevant. Discuss the following:
   - When consumers pay interest and fees for using credit, they are giving up the goods or services that they could have purchased with the money used to pay fees and interest.

- When consumers buy items now on credit, they must pay for the items with income earned in the future. They give up saving future income or purchasing items in the future in order to pay for items bought on credit in the past.

8. Distribute a copy of *Handout 4: Extra Credit Vocabulary Game* to each student. Tell students to choose any five of the vocabulary words and to write a very short definition in the space with the word.

9. Refer to Handout 4 and randomly call out a vocabulary word. Tell students that if the word called out is one they have defined on their sheet, they should put an "X" through the box for that word on their sheet. Tell the students that the first student who has all five of his or her boxes marked wins the game. However, the student must be able to define the five terms for the class without referring to his/her handout. Play more than one round for practice with vocabulary. (Optional: Award a small prize to the winners.)

10. Divide the class into pairs and provide each pair of students one set of ABCD cards made from *Handout 5: A, B, C and D Cards*. Tell the student pairs that they are going to take a test on payday loans. Explain that the test includes seven questions and each question has four possible answers. After hearing each question, pairs of students will have 30 seconds to discuss the question to arrive at an answer. When they hear "answer," they must hold up either the A, B, C or D card that corresponds to the letter of their answer.

11. Display *Visual 1: Payday Loan Quiz*. Reveal only one question at a time, read it aloud and allow 30 seconds for each pair of students to determine its answer. Refer to *Visual 1: Payday Loan Quiz—Answer Key* for correct answers.

12. Tell students that although consumer debt is talked about, sometimes it is viewed as a "fairy tale" and not something that is a real concern. Consumers often think that debt entrapment happens to someone else—like in a story.

13. Tell the class that an old song, "If You're Young at Heart," included the phrase, "Fairy tales can come true; it can happen to you." Distribute *Handout 6: Rachael's Story* to each student and direct them to read the story. Discuss the following:
    - Does this story seem like a fairy tale? *(Answers will vary.)* Why? *(Yes, because it begins with "Once upon a time." Things seemed to be going very well at first, but then problems occurred. No, because it doesn't have a happy ending.)*
    - Why does Rachael's life sound realistic to you? *(Answers will vary.)*

14. Distribute a copy of *Handout 7: Rachael's June Record* to each student. Explain that the handout is a record of finances that Rachael kept for June. Divide the class into pairs and provide each pair of students with a calculator to complete Rachael's record.

Answers for table

Total expenses	$3,272
Total income	$3,105
Monthly net (income – expenses)	–$167
Amount available to save	$0
New debt incurred in June	$300*

**Note: Although Rachael received only $255 for the payday loan, since $45 in fees was taken out upfront, she still owed the full $300 amount of the loan.*

15. Write the phrase "Hindsight is 20/20" on the board. Ask the students what they think this means. *(Answers will vary.)* Explain that the phrase means that it is always easier to understand a problem or an issue when looking back on it. Ask the students how this might apply to Rachael's problem. *(It might be easier for Rachael to look back now and see that her choice to take out a payday loan wasn't a good one.)*

16. Distribute a copy of *Handout 8: 20/20 Hindsight* to each student. Tell students to complete Handout 8 based on their analysis of Rachael's records on Handout 7. Discuss the following:
    - What advice did you have for Rachael regarding her debt? *(Answers will vary but might include budgeting so that expenses are not greater than income.)*
    - What alternatives did you recommend? *(Answers will vary but should include cutting back on some expenses.)*
    - What's the explanation for your recommendation? *(Answers will vary but should include a rationale for any expenses cut.)*
    - What would be the result of Rachael implementing your alternative? *(Answers will vary.)*

17. Distribute a copy of *Handout 9: Rachael's July Record* to each student. Allow students to work in pairs and provide a calculator for each pair. Tell students to analyze Rachael's income and expenses for July. Ask students to compare their analysis of Rachael's June record to their analysis of her July record.

Answers for table

Total expenses	$2,638	
Total income	$2,850	
Monthly net (income – expenses)	$212	
Amount available to save	$0 (need the monthly balance to pay bills not paid)	
New debt incurred in July	$940 in bills not paid	
	Life insurance	$325
	Car payment	$295
	Car insurance	$75
	Utilities	$245
	Total	**$940**

18. Discuss the following:
   - Is Rachael on the road to financial recovery? *(No. She has accumulated $940 in unpaid bills and has spent $90 more on payday loan renewal.)*
   - What happened in July? *(Rachael wasn't able to pay all of her bills.)*
   - What predictions can be made for August and future months? *(more fees, more debt, credit collectors calling, utilities cut off, car repossessed, no car insurance, no life insurance)*
   - What do you think about the direction in which Rachael is going financially? *(Answers will vary.)*
   - Is "Extra Credit" really just a fairy tale? *(Answers will vary but may include the fact that people can slip into debt very quickly if they aren't careful about their expenditures.)*
   - What actions do you think Rachael should take? *(Answers will vary but may include suggestions that Rachael think about ways to decrease her expenditures and make a plan to get her debt paid off.)*

19. Ask students to recall Rachael's credit card debt of $3,500 at 14 percent interest. Explain that the total amount paid on a credit card debt is determined by several things: the amount of the debt, the interest rate and the amount of time used to pay off the debt.

20. Distribute a copy of *Handout 10: How Much for How Long* to each student and assign completion of the handout as homework. Point out that to complete this assignment, students must use an online calculator found at http://www.bankrate.com/crt/calc/creditcardpay.asp to identify the difference the amount of the monthly payment makes in the total amount paid on a credit card debt. (Explain that the online calculator calculations are rounded and estimated based on general information.)

21. Distribute a copy of *Handout 11: Bad News and Good News* to each student. Tell the students to analyze Rachael's monthly expenses for June and July and to prepare a recommended budget for Rachael that includes making more than a $55 per month payment on her credit card debt. *(Answers will vary.)*

22. Allow time for students to present and defend their recommendations after completing Handout 11.

Closure

23. Ask students to move their desks to form a circle in the room. Tell students that they are going to review the important content learned in this lesson. Students who catch the sponge ball must recall a vocabulary word and its meaning before tossing the ball to another student. Start the review by tossing a sponge ball to a student. Continue until all students have had the opportunity to participate. (Refer to Handout 3 for vocabulary with definitions) Encourage students to connect each term to Rachael's story as well as to the content in the original article.

24. Review the definition for *opportunity cost* as the highest-valued alternative given up when a choice is made. Tell the students that this time a student who catches the ball must identify a possible opportunity cost of being caught in a debt trap. (Example: If you spend your money on payday loan fees, you might be giving up buying new clothes.)

Assessment

25. Remind the students about their discussion of fairy tales. Ask the students how most fairy tales end. *(happily, with the phrase "and they lived happily ever after")* Ask the students if Rachael's story looks as though it is headed toward an "and they lived happily ever after" ending. *(No.)* Why or why not? *(Because her choices are leading to more debt problems.)*

26. Tell students to create a final chapter for Rachael's story. Tell them that their chapter should include:
    - a brief summary of Rachael's financial problem, including definitions of terms such as "payday loan;" and

- actions and decisions Rachael would have to take in order for Claire and her to live happily ever after. As opposed to a fairy tale, however, their ending must provide realistic, possible solutions in order to create the "happily ever after." This means that students are not to include a "prince charming" ending because a man is not a financial plan.

Encourage students to share their story endings with the class.

Extension Activities

1. Tell students to collect data on the number of payday lending establishments in their community, town or city. As establishments are identified, list the names and locations on chart paper. As the list grows, ask students to note the different names used such as PayDay Advance, Cash Advance, Quick Cash, etc. If possible, plot the locations of the lending establishments on a city map using push pins. Identify two or more ways that payday loan establishments may benefit people and two ways that payday loans may be harmful to people. (Examples: A payday loan could be beneficial in a medical emergency when quick cash is needed; a payday loan may be harmful because it may enable people to spend more than they earn.)

2. Tell the students to use research skills to find the population of their community, town or city. Challenge students to calculate the number of payday loan establishments as compared to population, e.g., one payday loan establishment for every __________ people in our city.

3. Conclude the activity by asking students to write a paragraph using one of the following topic sentences. Direct students to use specific examples to support the topic sentence. Encourage students to use the vocabulary associated with this lesson. Suggest that they refer to the article *Extra Credit: The Rise of Short-term Liabilities* found in Handout 1, and tell them to cite references to the article.

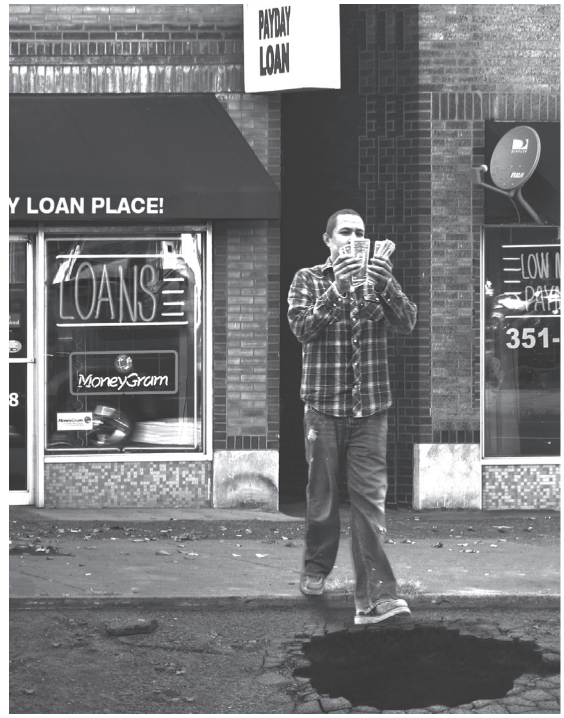
   A. There are several advantages to using payday loans.

   B. There are numerous disadvantages to using payday loans.

Handout 1: Extra Credit: The Rise of Short-term Liabilities

According to the 2004 Survey of Consumer Finances (SCF), the percentage of families holding debt rose from 72.3 percent in 1989 to 76.4 percent in 2004. Among families holding debt, the median value of the debt more than doubled during that time from $22,000 to $55,300 (in 2004 dollars). These numbers reflect both a rise in collateralized debt (e.g., mortgages) and uncollateralized debt (e.g., credit cards).

This shift toward more debt appears to have long-term ramifications for the U.S. economy, as evidenced by the growing number of personal bankruptcies over recent decades. Perhaps playing a role in this rise is the increase in debt accumulated via credit cards and payday loans.



Paper or Plastic?

In 1989, a total of 55.8 percent of American families owned at least one credit card; in 2004, a total of 74.9 percent owned at least one card. According to several economic studies, the characteristics of credit card holders have changed over time to include people who are riskier for the lenders. For example, a higher percentage of single people and renters now have a credit card. Also, workers with less job seniority, lower incomes and unskilled jobs are now more likely to hold a credit card. Attitudes toward borrowing have changed as well; for example, people increasingly borrow to finance things like vacations and living expenses.

Although credit card usage has increased across the income spectrum, the largest increases occurred among lower-income groups. (See the accompanying table.) Among those in the lowest 20 percent of the income distribution, the fraction with credit card debt nearly doubled between 1989 and 2004, and their median credit card debt increased to $1,000 from $400. For those in the next lowest 20 percent, the fraction with credit card debt increased by 51 percent, and their median debt doubled to $1,800.

Between 1992 and 2006, the total dollar amount of credit card loans nearly tripled, while the dollar

Credit Card Debt by Income Distribution

	Percentage with credit card debt			Median credit card debt (2004 dollars)		
	1989	**2004**	**Difference**	**1989**	**2004**	**Difference**
All families	39.7	46.2	6.5	$1,300	$2,200	$900
Percentiles of income < 20 percent	15.0	29.1	14.1	$400	$1,000	$600
20 – 39.9 percent	28.2	42.5	14.3	$900	$1,800	$900
40 – 59.9 percent	48.8	55.0	6.2	$1,200	$2,200	$1,000
60 – 79.9 percent	57.4	56.2	–1.2	$1,500	$3,000	$1,500
80 – 100 percent	49.0	48.1	–0.9	$2,600	$3,400	$800

SOURCE: 2004 Survey of Consumer Finances. See www.federalreserve.gov/pubs/oss/oss2/2004/scf2004home.html.

amount of loans that are 90 days delinquent more than tripled. At the end of 2006, FDIC-insured institutions had $385 billion in credit card loans to individuals, and $6.5 billion were past due 90 days or more (1.7 percent of the total).

What's in the Balance?

In addition to carrying a balance, borrowers do not appear to rush to pay off their credit cards. Several economists have found that some consumers carry credit card balances even though they have sufficient funds in the bank to pay off their high-interest debt. Economist Irina Telyukova found that about 28 percent of those surveyed had at least $500 both in credit card debt and liquid assets. This group held an average credit card debt of $5,766 and an average of $7,237 in liquid assets. Furthermore, the average interest rate on the debt was 13.7 percent, compared with a rate of only about 1 percent on their liquid assets.

Telyukova hypothesized that households keep liquid assets for payments where cash is required. While many of these expenses are predictable, others may arise in an emergency. To protect themselves in the event such a case arises, households may forgo paying off credit card debt in order to keep cash available.

I Want It All, and I Want It Now

Another increasingly common form of short-term debt is the payday loan. According to the Center for Responsible Lending (CRL), from 2000 to 2003, the industry quadrupled in size to $40 billion. Payday loans are designed to lend small amounts of money for short amounts of time, usually two weeks. Typical interest rates for two weeks can range from 15 to 18 percent, which translates into about a 400 percent annual interest rate. Payments are due on the borrower's payday, but the loan may be renewed with additional fees.

Similar to credit cards, payday loans have become popular among lower-income households. A CRL report asserts that 90 percent of lenders' revenue comes from borrowers who have five or more loans per year. To demonstrate, an average borrower renews a loan eight times and ends up paying back $793 for a $325 loan. The CRL estimates that Americans paid $4.2 billion in payday loan fees in 2005.

Economists Paige Skiba and Jeremy Tobacman found that applicants for payday loans from a particular lender in Texas had an average monthly income of $1,699 and $235 in their checking account. Additionally, 77 percent of the applicants were black or Hispanic and 62 percent were women. The results of the study suggest that access to loans can be habit-forming. Within one year, a consumer whose first-time application for a payday loan was approved would apply for another loan an average of 8.4 more times; in comparison, a consumer whose first-time application was rejected would apply 1.8 more times on average.

You Get What You (Don't) Pay For

Americans appear willing to trade substantial interest payments for access to short-term credit markets. But does this new behavior have detrimental long-term effects? According to a study by economist Michelle White, an increase in the amount of revolving debt (for example, credit card debt) per household coincided with an increase in personal bankruptcy filings from the 1980s to 2005. There were 5.4 times more bankruptcies in 2004 than in 1980, and revolving debt per household was 4.6 times larger in 2004 than in 1980.

White discussed other possible explanations for the increase in bankruptcy filings, such as job loss and medical bills. These types of adverse events, however, have not increased since 1980. She concluded, therefore, that the rise in personal bankruptcies can be attributed in large part to the rise in credit card debt.

Similarly, the payday loan applicants in Skiba and Tobacman's study were six times more likely to file for bankruptcy between January 2001 and June 2005 than the general population in Texas.

Credit cards and payday loans can be convenient for some people as a means to borrow money for a relatively short period of time. However, the recent rise in short-term liabilities—especially by lower-income households—may have long-term implications for the economy, as demonstrated by the apparent correlation with bankruptcy filings.

This article was adapted from "Extra Credit: The Rise of Short-term Liabilities," which was written by Kristie M. Engemann, a research analyst, and Michael T. Owyang, an economist, both of the Federal Reserve Bank of St. Louis, and was published in the April 2008 issue of The Regional Economist, *a St. Louis Fed publication.*

Handout 2: Extra Credit Discussion Questions

1. What is the change in percentage of families holding debt in 2004 compared to 1989?

2. What trends are reflected in personal bankruptcy filings?

3. What trend is reflected regarding credit card use?

4. What evidence is there to suggest that consumers' ability to repay credit card debt has decreased?

5. What trend is reflected in the growth of payday loans?

6. What observations can be made regarding credit card debt and the income level of credit card holders?

7. What relationship can be identified between payday loans, credit card debt and bankruptcies?

Handout 2: Extra Credit Discussion Questions—Answer Key

1. What is the change in the percentage of families holding debt in 2004 compared to 1989? *An increase from 72.3 percent in 1989 to 76.4 percent in 2004.*

2. What trends are reflected in personal bankruptcy filings? *Growing; 5.4 times more bankruptcies in 2004 than in 1980.*

3. What trend is reflected regarding credit card use? *Growing; in 1989, 55.8 percent of American families owned at least one credit card and this increased to 74.9 percent in 2004. Between 1992 and 2006, the total dollar amount of credit card loans nearly tripled.*

4. What evidence is there to suggest that consumers' ability to repay credit card debt has decreased? *Between 1992 and 2006, the dollar amount of loans that are 90 days delinquent more than tripled. At the end of 2006, 1.7 percent of the total amount of credit card loans was 90 days or more past due.*

5. What trend is reflected in the growth of payday loans? *From 2000 to 2003, the industry quadrupled in size to $40 billion.*

6. What observations can be made regarding credit card debt and the income level of credit card holders? *The bottom 60 percent income level showed an increase in credit card debt between 1989 and 2004, while the top 40 percent income level showed a decrease in credit card debt in the same period.*

7. What relationship can be identified between payday loans, credit card debt and bankruptcies? *An increase in the amount of revolving debt per household, especially credit card debt, coincided with an increase in personal bankruptcy filings from the 1980s to 2005.*

Handout 3: Vocabulary Definitions

Average – the sum of all the numbers in a list or set divided by the number of items in the list or set. The mean is the most commonly-used type of average and is often referred to simply as "the average." The term "mean" or "arithmetic mean" is preferred in mathematics and statistics to distinguish it from other averages such as the median and the mode.

Assets – items that one owns; they can be financial or non-financial in nature.

Bankruptcy – legally declared inability or impairment of ability of an individual or organization to pay their creditors.

Borrower – someone who obtains something on loan with the promise or understanding of returning it or its equivalent. Normally, when borrowing money people repay the amount of the loan with an additional payment called "interest."

Cash – currency and coin (dollars and cents).

Collateral – a financial (stock, bond) or physical (car, house) asset used to secure a loan. A lender is able to take the asset if the borrower fails to repay the loan.

Consumer – a person whose wants are satisfied by using goods and services.

Cost – something that is unfavorable to a decision maker.

Credit card – represents an agreement between a lender—the institution issuing the card—and the cardholder. Credit cards may be used repeatedly to buy products or services or to borrow money on credit. Credit cards are issued by banks, savings and loans, retail stores, and other businesses.

Credit market – a mechanism by which providers of credit meet with users of credit. The credit market represents options in the marketplace available to meet the demand for credit by consumers

Debt – money owed for goods and services purchased or for money borrowed.

Delinquent – past the time for payment; overdue.

Expenses – costs people incur for goods and services. Expenses are often categorized as fixed, variable and periodic. Fixed expenses are those that occur each month in a regular amount such as rent, car payment or mortgage payment. Variable expenses are those that change from time period to time period, such as food, clothing, gasoline and entertainment. Periodic expenses are those that occur several times a year, such as car insurance or life insurance payments.

Fees – a fixed charge, compensation, or payment for a good or service. Lenders charge fees when payments are late or missed. Banks charge fees when accounts are overdrawn.

Income – payments people earn for providing resources in the market. People earn wages or salaries when they provide human resources. People can also earn income in the form of rent, interest and profit.

Interest – the price of using someone else's money. Banks accept savers' deposits and use those deposits to make loans. The interest paid by borrowers is the price of using someone else's money.

Liabilities – that which is owed to another.

Lender – a person or business that allows the temporary use or possession of something with the understanding that it is to be returned. Normally, when money is loaned, the amount loaned is returned with interest.

Loan – an amount of money provided with the expectation that the amount will be repaid, usually with interest.

Median – the number separating the higher half of a sample from the lower half. The median of a finite list of numbers can be found by arranging all the observations from lowest value to highest value and picking the middle one.

Opportunity cost – the highest-valued alternative given up when a choice is made. If a student is able to choose between watching television, playing soccer or playing video games after school, and the student chooses to play a video game, then the students' opportunity cost is either playing soccer or watching television—whichever activity the student would have chosen had he not chosen to play video games.

Payday loan – a relatively small, short-term loan that is intended to cover a borrower's expenses until his or her next payday.

Revenue – money received by businesses in payment for goods and services.

Risk – exposure to loss of the principal (initial deposit or investment amount) due to a variety of causes such as interest rate changes, stock market volatility, business failure or changes in rates of inflation; in business, the likelihood of loss or reduced profit; the danger or probability of loss to an individual.

Save – to keep some money rather than spend it on current consumption. Income that is saved is neither spent nor used to pay taxes.

Handout 4: Extra Credit Vocabulary Game

EXTRA CREDIT				
risk	revenue	fees	consumer	average
lender	cost	debt	expenses	interest
bankruptcy	income	credit market	credit card	payday loan
borrower	save	collateral	delinquent	loan
opportunity cost	median	assets	liabilities	cash

Handout 5: A, B, C, D Cards

A	B
C	D

Handout 6: Rachael's Story

Chapter One

Once upon a time there was a single mom named Rachael. Rachael was fortunate to have a good job, and she took pride in her financial independence. Her take-home pay was $2,500 a month after taxes, and she also received $350 each month in child support for her three-year old daughter, Claire. Rachael had two credit cards with a combined $3,500 balance, and although there was still $700 in available credit between the two cards, she decided not to make any more charges on the cards so that she could pay them off. The interest rate on both cards was 14 percent. She was very careful to make the minimum payment by the due date to avoid late fees and was very pleased that this credit card debt would soon be history.

Rachael lived several miles from her job and was dependent upon her car to commute to work each day. With rising gasoline prices, more and more of her monthly budget was being used to pay for gas. Rachael noticed that food prices were also rising. Even though she shopped very carefully and used coupons, the amount she paid for groceries was rising each week. To help reduce expenses, she started taking her lunch to work each day and tried to avoid impulse buying. Claire attended day care while Rachael worked, and the cost of day care was $120 per week. In order to work, Rachael had to have day care for Claire.

Then one day in the month of June Rachael realized that she was having trouble paying her bills. She found that she had made payments from her checking account, and she didn't have enough money in her account to cover the payments. As a result she had to pay an overdraft fee. Rachael needed extra credit to make ends meet; so, she secured a two-week payday loan. The loan was for $300, but she only received $255 in cash because there was a $45 fee that was deducted from the loan amount at the time the loan was secured. Although Rachael had a steady income and was very cautious in managing her money, things were getting tough. Claire did not even get the new movie that she had asked for or the new pair of shoes that she needed. Oh well, Claire could get the movie, new shoes and an extra prize in July.

Chapter Two

In July, Rachael was hopeful that she could manage to pay all her bills and get the $300 payday loan paid back. When the payday loan came due on July 7, Rachael was not sure that she would have enough money to pay all of her July bills; so, she decided to renew the loan and pay an additional $45 charge. By renewing the loan, she would have another two weeks to get it paid and maybe by then she would have the money. At least the payday loan should keep her from having an overdraft charge on her bank account. Knowing that she had trouble paying all her bills in June and trying

Handout 6: Rachael's Story—cont.

to save to pay back the payday loan, she cut back spending in personal items and eating out. She hoped that this would help. It would also help that she would not have to buy a tire for her car or pay for the car license since these were one-time expenses in June—but she would need an oil change and tire rotation, which would cost $45.

Rachael knew the regular payments on her credit card accounts, car loan, insurance on her car, utilities, daycare, satellite TV and internet fee would be due, and a check-up at the dentist would cost $75. Also, her quarterly life insurance payment for $325 was due in July, as well as the newspaper subscription for $75. Claire, of course, would expect that new movie, new shoes and the extra prize that was promised to her. On July 21, Rachael did not have the $300 to pay the payday loan so she renewed it again for another two weeks. To renew the loan, Rachael paid the payday lender another $45 in renewal fees. She had unpaid bills, she had spent $90 in July to renew the payday loan and she still owed the full $300 on the loan. Rachael began to wonder what to do. It seemed there was no end to her financial worries.

Handout 7: Rachael's June Record

Here is Rachael's record of income and expenses for June. Use information from her record to complete the chart at the bottom of the page.

Rachael's Income and Expenditures for June			
Description	Income	Expense	Explanation for June
Car maintenance		$78	Tire
Car payment		$295	
Cell phone bill		$69	
Child support payment	$350		
Clothing purchase		$78	Dress
2 Credit cards		$55	Minimum payments
Daycare payments		$480	
Donations and gifts		$54	Birthday gift and charity
Gas for car		$252	
Groceries		$444	
Insurance on car		$75	Monthly premium
Internet payment		$32	
License for car		$27	Annual fee
Life insurance		$0	Billed quarterly
Meals out and entertainment		$89	
Medical/Dental		$45	Prescriptions
Misc. daily expenses		$100	Grooming, personal
Misc. household expense		$25	Cleaning, laundry
Overdraft fee		$32	
Paycheck	$2,500		
Payday loan	$255	$45	
Rent		$700	
Satellite TV		$52	
Utility payments		$245	

June Summary	
Total expenses	$
Total income	$
Monthly net (income – expenses)	$
Amount available to save	$
New debt incurred in June	$

Handout 8: 20/20 Hindsight

The saying "Hindsight is 20/20" refers to being able to see things more clearly after the events have happened. Use "hindsight" to analyze Rachael's June expenses. Some of her expenses were for goods and services previously consumed. For example, the cell phone bill, the utility bills, which included water and electricity, are charges incurred for usage in May. Some expenses were paid for as they were incurred, such as gas and groceries. Are there expenses that could be cut in the future?

1. Use "hindsight" to analyze Rachael's debt. She now has two debts: credit cards and a payday loan. What advice could be helpful to Rachael in reference to her debt?

2. Give Rachael some advice based on "hindsight" in analyzing her financial situation. What are three possible alternatives for the spending decisions she made? Explain the reasoning behind each suggested alternative. What would be the result of each suggested alternative?

Alternative	Explanation	Result

Handout 9: Rachael's July Record

Here is Rachael's record of income and expenses for July. Use information from her record to complete the chart at the bottom of the page.

Rachael's Income and Expenditures for July				
Description	Income	Expense/June	Expense/July	Explanation for July
Car maintenance		$78	$45	Oil change/tire rotation
Car payment		$295	$0	Did not make payment of $295
Cell phone bill		$69	$65	
Child support payment	$350			
Clothing purchase		$78	$53	Shoes and clothes
2 Credit cards		$55	$55	
Daycare payments		$480	$480	
Donations and gifts		$54	$52	Claire's present and gift
Gas for car		$252	$258	
Groceries		$444	$441	
Insurance on car		$75	$0	Did not make payment of $75
Internet payment		$32	$32	
License for car		$27	$0	
Life insurance		$0	$0	Did not make payment of $325
Meals out and entertainment		$89	$65	
Medical/Dental		$45	$75	Dentist
Misc. daily expenses		$100	$75	Grooming, personal
Misc. household expense		$25	$100	Cleaning, laundry, newspaper
Overdraft fee		$32	$0	
Paycheck	$2,500			
Payday loan		$45	$90	Renewed payday loan on July 7 and July 21
Rent		$700	$700	
Satellite TV		$52	$52	
Utility payments		$245	$0	Did not make payment of $245

July Summary	
Total expenses	$
Total income	$
Monthly net (income – expenses)	$
Amount available to save	$
New debt incurred in June	$

Handout 10: How Much for How Long

Rachael has $3,500 in credit card debt at 14 percent interest. She knows the total amount paid on this debt will be determined by how long she takes to pay it off and how much she pays each month. In planning her budget, she wants to determine a fixed monthly amount to pay on this debt to reduce the total amount paid. Complete the chart and answer the questions below. Use the online calculator found at http://www.bankrate.com/crt/calc/creditcardpay.asp to help determine the number of months it will take to pay off the debt. Next, multiply the monthly payment times the number of months to determine the total amount paid. Then subtract $3,500 (the amount of the credit card debt) from the total amount paid to determine the amount of interest paid on the debt.

Monthly payment	Number of months to pay off the debt	Total amount paid	Interest paid on the debt
$55		$	$
$75		$	$
$100		$	$
$125		$	$
$150		$	$
$200		$	$

1. How much would Rachael save if she chose to pay $75 a month instead of paying $55 a month?

2. How much would Rachael save if she chose to pay $100 a month instead of $55 a month?

3. How much would Rachael save if she chose to pay $200 a month instead of $55 a month?

4. How much longer would it take to pay off her credit card debt if she paid $55 a month instead of $75 a month?

5. How much longer would it take to pay off her credit card debt if she paid $55 a month instead of $100 a month?

6. How much longer would it take to pay off her credit card debt if she paid $55 a month instead of $200 a month?

Handout 10: How Much for How Long—Answer Key

Rachael has $3,500 in credit card debt at 14 percent interest. She knows the total amount paid on this debt will be determined by how long she takes to pay it off and how much she pays each month. In planning her budget, she wants to determine a fixed monthly amount to pay on this debt to reduce the total amount paid. Complete the chart and answer the questions below. Use the online calculator found at http://www.bankrate.com/crt/calc/creditcardpay.asp to help determine the number of months it will take to pay off the debt. Next, multiply the monthly payment times the number of months to determine the total amount paid. Then subtract $3,500 (the amount of the credit card debt) from the total amount paid to determine the amount of interest paid on the debt.

Monthly payment	Number of months to pay off the debt	Total amount paid	Interest paid on the debt
$55	115	$6,325	$2,825
$75	68	$5,100	$1,600
$100	45	$4,500	$1,000
$125	34	$4,250	$750
$150	28	$4,200	$700
$200	20	$4,000	$500

1. How much would Rachael save if she chose to pay $75 a month instead of paying $55 a month? *$6,325 – $5,100 = $1,225 (or $2,825 – $1,600 = $1,225)*

2. How much would Rachael save if she chose to pay $100 a month instead of $55 a month? *$6,325 – $4,500 = $1,825 (or $2,825 – $1,000 = $1,825)*

3. How much would Rachael save if she chose to pay $200 a month instead of $55 a month? *$6,325 – $4,000 = $2,325 (or $2,825 – $500 = $2,325)*

4. How much longer would it take to pay off her credit card debt if she paid $55 a month instead of $75 a month? *115 – 68 = 47 months*

5. How much longer would it take to pay off her credit card debt if she paid $55 a month instead of $100 a month? *115 – 45 = 55 months*

6. How much longer would it take to pay off her credit card debt if she paid $55 a month instead of $200 a month? *115 – 20 = 95 months*

Handout 11: Bad News and Good News

Refer to Rachael's expenses and income for June and July found in Handout 7 and Handout 9 to recommend a monthly budget for Rachael that includes paying more than $55 a month on her credit card balance of $3,500. The budget must include a fixed monthly payment of $75, $100, $125, $150 or $200 for this credit card debt. The total expenditures for the month cannot exceed her income of $2,850, and she cannot accumulate any new debt. The bad news is that some expenses must be cut. The good news is that her credit card debt will be paid off in a shorter amount of time, and she will be living within her means without accumulating more debt.

Recommended Budget			
Description	Income	Expense	Explanation for decrease or increase in budget
Car maintenance			
Car payment			
Cell phone bill			
Child support payment	$350		
Clothing purchase			
2 Credit cards			
Daycare			
Donations and gifts			
Gas for car			
Groceries			
Insurance on car			
Internet payment			
License for car			
Life insurance			
Meals out and entertainment			
Medical/Dental			
Misc. daily expenses			
Misc. household expense			
Overdraft fee			
Paycheck	$2,500		
Payday loan			
Rent			
Satellite TV			
Utilities payment			

Handout 11: Bad News and Good News—cont.

Budget Summary	
Total expenses	$
Total income	$
Monthly net (income – expenses)	$
Amount available to save	$

Visual 1: Payday Loan Quiz

1. Payday loans require full repayment within a short period of time. The loan generally comes due in:

   A. two weeks.

   B. one month.

   C. six months.

   D. 90 days.

2. The percent of lenders' revenue that comes from borrowers who have five or more loans per year is:

   A. about 25 percent.

   B. about 50 percent.

   C. about 75 percent.

   D. about 90 percent.

3. From 2000 to 2003, the payday loan industry:

   A. doubled in size.

   B. tripled in size.

   C. quadrupled in size.

   D. increased in size in proportion to the increase in population growth.

4. The average annual interest rate for a payday loan is:

   A. 15 percent.

   B. 50 percent.

   C. 200 percent.

   D. 400 percent.

Visual 1: Payday Loan Quiz—cont.

5. A payday loan borrower usually:
   - A. takes advantage of the one-time two-week loan and walks away free and clear.
   - B. renews the same payday loan several times before paying it off.
   - C. uses the loan as an occasional emergency loan.
   - D. pays off the loan before it is due.

6. Payday loans:
   - A. have become popular among lower-income households.
   - B. have become popular among middle-income households.
   - C. have become popular among upper-income households.
   - D. have become less popular among all income groups.

7. Payday lenders:
   - A. rely on one-time customers for most of their revenues.
   - B. make most of their revenue from customers who have two or three loans per year.
   - C. make most of their revenue from customers who have three or four loans per year.
   - D. make most of their revenue from customers who have five or more loans per year.

Visual 1: Payday Loan Quiz—Answer Key

1. Payday loans require full repayment within a short period of time. The loan generally comes due in:

   A. two weeks.

   B. one month.

   C. six months.

   D. 90 days.

2. The percent of lenders' revenue that comes from borrowers who have five or more loans per year is:

   A. about 25 percent.

   B. about 50 percent.

   C. about 75 percent.

   D. about 90 percent.

3. From 2000 to 2003, the payday loan industry:

   A. doubled in size.

   B. tripled in size.

   C. quadrupled in size.

   D. increased in size in proportion to the increase in population growth.

4. The average annual interest rate for a payday loan is:

   A. 15 percent.

   B. 50 percent.

   C. 200 percent.

   D. 400 percent.

Visual 1: Payday Loan Quiz—Answer Key—cont.

5. A payday loan borrower usually:

   A. takes advantage of the one-time two-week loan and walks away free and clear.

   B. renews the same payday loan several times before paying it off.

   C. uses the loan as an occasional emergency loan.

   D. pays off the loan before it is due.

6. Payday loans:

   A. have become popular among lower-income households.

   B. have become popular among middle-income households.

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7. Payday lenders:

   A. rely on one-time customers for most of their revenues.

   B. make most of their revenue from customers who have two or three loans per year.

   C. make most of their revenue from customers who have three or four loans per year.

   D. make most of their revenue from customers who have five or more loans per year.