Debt

Lesson 5: Teacher's Guide | Hall of Fame: Ages 18+

FINANCIAL FOOTBALL

Avoiding Fumbles with Debt Management

Understanding the costs and benefits of debt is essential to managing it effectively throughout life. This 45-minute module will help you prepare students to think critically about types of debt, debt loads, and strategies for managing debt.

Getting Your Class Game-Ready: Each football game won is the result of careful planning, strategic plays, and judgment calls. There is a risk with each pass and rush that yards might be lost instead of gained on the path to the goal line.

In life, managing debt demands similar planning, careful decision-making, and a solid understanding of the risks, costs, and benefits. With a solid management plan, taking out loans can provide funds that allow students to reach goals such as attending college or buying a house. However, debt can also spiral out of control, negatively impacting their financial opportunities now and in the future. While the topic of debt may seem overwhelming, it's important for them to keep their head in the game and take informed action to reach their goals.

Module Level: Hall of Fame, Ages 18+

Time Outline: 45 minutes total

Subjects: Economics, Math, Finance, Consumer Sciences, Life Skills

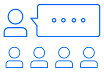
Materials: Facilitators may print and photocopy handouts and quizzes for students, or direct them to the online resources below.

- **Pre- and Post-Test questions:** Use this short grouping of questions as a quick, formative assessment for the Debt module or as a Pre- and Post-Test at the beginning and completion of the entire module series.
- **Practical Money Skills Debt resources:** practicalmoneyskills.com/ff40
- **Glossary of Terms:** Learn basic financial concepts with this list of terms.

Icon Key

Activity

Assign the given activity to students and have them complete it individually or with a group, depending on the instructions.



Ask

Pose questions to your students and have them respond.

Assign

Designate individuals or groups to complete a particular assignment.

Debrief

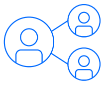
Examine the activities as a whole group and compare answers and findings.

Did You Know?

Share these fun facts with students throughout the lesson.

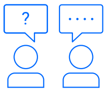
Pre- and Post-Test

Have students take the Pre-Test before the lesson, and take the Post-Test after completing the lesson.



Share

Read or paraphrase the lesson content to students.



Turn and Talk

Have students turn to a partner and discuss a specific topic or question.

Table of Contents

Learning Objectives

– Explore types of debt and their costs and benefits
– Calculate debt-to-income ratio
– Discover strategies to manage and alleviate debt
– Discuss the dangesr of debt and how to prevent lasting negative impacts
– Identify tools for debt management planning

Key Terms and Concepts

Before you start the lesson, review the key terms and concepts below. The answers to each question will help you get students prepped and game-ready. Get deeper information around these concepts in the Facilitator Script section on pages 6 to 9 of this guide.

What types of loans are sometimes considered good debt? Bad debt?

Borrowing money (taking on debt) can help you reach goals but it can also become a burden. To decide whether a debt is good or bad for your personal situation, you will need to consider its benefits and costs. In general, debt that helps you earn more in the long term with proper planning, such as school loans, business loans, or real estate mortgages, can be considered good debt. Meanwhile, debt that has no potential of making you money is considered bad debt. In other words, good debt helps your future self and bad debt hurts your future self.

What is debt load and how is it calculated?

The sum total of all the money you owe is called your debt load. To determine whether your load is more than you can afford, you'll want to calculate your debt-to-income ratio by comparing the amount you owe to the amount you earn.

How much debt is too much debt?

Excessive debt is a problem that only gets worse the longer it continues. Warning signs that debt is getting out of hand include not being able to pay bills and owing late fees. Lenders typically like to see a debt-to-income ratio (DTI) of 35% or less.

When does it make sense to take out a loan?

There are many different types of loans:

- Student loans
- Mortgage loans
- Auto loans
- Personal loans
- Peer-to-peer loans

Key Terms and Concepts, cont.

Taking out a loan is a big responsibility and commitment. When you're choosing a loan, it's important to consider the interest rate, length of the loan, and overall cost of borrowing the money. Loans can allow you to leverage time — giving you access to opportunities such as education, real estate, and transportation. However, debt can also quickly grow and get out of hand, so it's critical to consider how much debt you can afford to repay.

How can I prevent debt problems?

- Keep track of what you owe and monitor your credit report for accuracy
- Avoid borrowing more money than you can afford to repay
- Not everyone receives a steady paycheck. If your income varies, it is of particular importance to minimize your debt burden
- Create a plan for repayment when considering loan options
- Pay bills on time; if you can't make a payment, call to notify and negotiate with your creditor
- Know your consumer rights. Find out more at the Consumer Financial Protection Bureau's website

Did You Know?

If you can't afford your monthly payments, your creditors may be willing to put you on a new payment plan.

How can I rebuild my finances after debt?

You can't rewrite your credit history, but you can rebuild it. Whether you've undergone a major life event or filed for bankruptcy, reestablishing your credit rating takes time and discipline, so it's helpful to create a plan you can stick to. You'll need to demonstrate that you're able to pay your bills on time every month and make regular repayments to a credit line.

Five ways to rebuild financial credibility:

- Consider a credit builder loan
- Using a secured credit card account and avoiding balances greater than 9% of the credit limit
- Becoming an authorized user who has a good credit score
- Making payments on time
- Reducing total debt balances

Module Section Outline with Facilitator Script

Introduction: Warm-Up

Quick write: Have students spend 5 to 10 minutes writing on the following topic: Is debt always bad? When might debt be useful and why? If time allows, have them share their responses with the class.

Optional Pre-Test: Refer students to page 5 of the Student Activities guide. Have them answer the questions with the most appropriate answer, noting a, b, c or d or filling in the blank.

Types of Debt: Weighing the Benefits and Costs

Group Brainstorm: Draw a t-chart on the board with two columns, "Good Debt" (usually useful) and "Bad Debt." (risky).

Share: Explain to students that, in dealing with debt, it's important to recognize that there are various types of debt and they won't always result in the same outcome. When planned properly, going into debt for school or business purposes or taking out a loan for real estate (such as a mortgage) could be considered investments that might yield greater financial earnings for you in the future (good debt). This kind of debt may be costly in the short term, but could potentially end up paying for itself in the long term. However, debt that does not invest in anything is simply a financial burden in both the short term and the long term (bad debt). This is the kind of debt that must be managed especially carefully to avoid letting it quickly spiral out of control.

A good rule of thumb is that "good debt" helps to improve your future self.

Ask: Where would each of the choices/situations below belong on the t-chart?

- Monthly mortgage that is less than 25% of your monthly net pay (usually useful)
- Credit card debt less than 10% of your credit limit and paid off each month (usually useful)
- Credit card debt that is 90% of your credit limit and you're only able to make minimum payments (risky)
- Payday loan: While there is no set definition of a payday loan, it is usually a short-term, high-cost loan, generally for $500 or less; it is typically due on your next payday. Depending on your state law, payday loans may be available through storefront payday lenders or online. (risky)
- Auto title loan: Auto title loans can be very expensive. If you cannot repay the money you owe, the lender can take your vehicle. (risky)
- Monthly auto loan that is less than 5% of your monthly net pay (usually useful)

Module Section Outline with Facilitator Script, cont.

Share: Explain to students that taking out a loan is a big responsibility and commitment. When you're choosing a loan, it's important to consider the interest rate, length of the loan, and overall cost of borrowing the money. Loans can allow you to leverage time — giving you access to opportunities such as education, real estate, and transportation. However, debt can also quickly grow and get out of hand, so it's critical to consider how much debt you can afford to repay.

Group Discussion: Ask students the following questions and facilitate a group discussion. What things are important to consider before taking out a loan? How are people influenced to over-borrow?

Strategies for Managing Debt

Share: Explain to students that managing debt demands planning, careful decision-making, and a solid understanding of the risks, costs, and benefits. There are many different types of loans:

- Student Loans – If you need to borrow money to cover your college tuition, you normally take out a student loan. There are a few options for what kind of loan you would apply for, including federal loans as well as loans from private companies.
- Mortgage Loans – Buying a home can often require applying for a mortgage loan. Different interest rates and repayment times can greatly affect a mortgage loan's impact on your finances.
- Auto Loans – You are able to buy and finance a car through auto loans from car dealerships, banks, and credit unions. You may also take out a home equity loan, which allows you to use your home as collateral for your auto loan. Home equity loans can also be used to pay for education, home improvements, or to pay off or consolidate higher-interest debts, such as a credit card balance.
- Home Equity Loans – A home equity loan; also known as an "equity loan," a home-equity installment loan, or a second mortgage; is a type of consumer debt. It allows home owners to borrow against their equity in the residence. The loan is based on the difference between the homeowner's equity and the home's current market value.
- Personal Loans – A personal loan can be used to cover various expenses, from repaying credit card debt to taking an expensive vacation, at your discretion. Personal loans can be secured or unsecured, depending on both whether you have collateral and the risk you want to take. To get a secured loan, the borrower needs to pledge some asset, such as a home or a car, to serve as collateral for the loan. Unsecured loans are approved without the need for collateral. Borrowers can qualify for the loan based on their income and credit history.
- Peer-to-Peer Loans – You can use an online service to be matched with a peer lender, whether you want a loan for personal purposes or your business. Many of these loans are unsecured, and since operations are conducted entirely online you should approach peer-to-peer loans with caution.

Module Section Outline with Facilitator Script, cont.

Taking out loans can provide funds that allow you to reach goals such as attending college or buying a house, as long as you have a solid plan for paying them back on time. However, when mismanaged, debt can also spiral out of control, negatively impacting your financial opportunities now and in the future. This is why it's important to only take out a loan amount that you're able to pay back on time so that you don't incur interest.

Activity:

Part 1: Before having students complete the Examining Debt Load activity on page 7 of the Student Activities guide, divide the class into two teams. Each team is given seven index cards, one for each of the following seven debts or loans. Each team works together to determine an interest rate and loan amount based on the following ranges in these seven categories; they should write the interest rates and loan amounts they've determined on their index cards.

- Auto loan index card: 0% - 20%, $1,000 - $10,000
- Credit card debt #1 index card: 12% - 34%, $250 - $15,000
- Credit card debt #2 index card: 12% - 34%, $250 - $15,000
- Credit card debt #3 index card: 12% - 34%, $250 - $15,000
- Mortgage index card: 4% - 5%, $100,000 - $300,000
- Payday loan index card: 300% - 450%, $350 - $500
- Auto title loan index card: 750%, $2,500 - $10,000

Part 2: Each team then uses a piece of paper to write down an answer key that shows the order in which they'll repay their seven debts, using one of the following repayment strategies. You can check each team's answers using the answer key on page 12 of this guide.

Debt Snowball Method - This method of paying off loans works by prioritizing debts based on their size. By paying off smaller loans first, you'll be able to pay off several loans earlier on, and your payments "snowball" as you're psychologically rewarded. Many people feel more motivated to pay off loans if they can see visible progress.

Debt Avalanche Method - Paying off debt through the debt avalanche method means first making the minimum payment on each debt, then using any remaining money to start paying off the debt that has the highest interest rate. Once you've paid off your highest interest rate debt, tackle the debt with the next highest interest. Using this method can result in paying off debt more quickly while reducing overall interest rates.

Part 3: The teams swap cards and compete. The team that can first correctly order its index cards for each strategy wins. The teacher holds each team's answer key and acts as the referee.

Module Section Outline with Facilitator Script, cont.

Examining Debt Load

Share: Explain to students that an important question you should ask yourself each time you consider taking on debt is how much you can afford to borrow. When you answer this question for yourself based on your goals, income, and potential risks, you can more easily avoid borrowing more than you can afford to pay back.

The sum total of all the money you owe is what's commonly known as your debt load. To determine whether your debt load is more than you can afford, calculate your debt/income ratio by comparing the amount you owe to the amount you earn.

Activity:

Part 1: Review John and Susan's personal finances:

- John has an average monthly income of $4,200 after taxes; a monthly mortgage of $1,100; and a debt of $700.

- Susan has an average monthly income of $5,400 after taxes; a monthly mortgage of $1,700; and a debt of $200.

Part 2: Read Understanding Debt Load. practicalmoneyskills.com/ff41

Part 3: Based on what you read, calculate who has a better debt-to-income ratio: John or Susan. (Answer: Susan)

Rebuilding Your Finances & Debt Counseling

Share: Explain to students that rebuilding your credit and building your credit for the first time are not the same thing, but are similar. Assume you are under the age of 18 and your parents have a great credit score. Read Rebuilding Your Finances (practicalmoneyskills.com/ff42) and identify the strategy you can use as a minor, with your parents' help, to build your credit history. (Answer: get added to their credit line as an authorized user.) If your parents do not have good credit and are unable to add you to their lines of credit, you should pay any of your own personal bills like a cell phone or car payment on time to start establishing creditworthiness.

Closing: Post-Test

Group Discussion: Explain to students that borrowing money can be useful sometimes. Ask students the following question and facilitate a group discussion: What is one strategy you can use to manage debt effectively?

Optional Post-Test: Direct students to open page 5 of the Student Activities guide to take this test. Have students answer the questions with the most appropriate answer, noting a, b, c or d or filling in the blank.

Lesson 5 Debt: Answer Keys

> Debt Pre- and Post-Test

> Strategies for Managing Debt handout

> Examining Debt Load handout

Debt Pre- and Post-Test

Directions: Direct students to open page 5 of the Student Activities guide to take this test. Have students answer the questions with the most appropriate answer, noting a, b, c, d or filling in the blank.

Answer Key

1. Your personal debt is:

a. The PIN code for your debit card

b. What is in your savings account

c. What you owe in money, goods, or services

d. The same as your credit score

2. Which of the following is a warning sign that you could have a problem with debt?

a. You aren't sure how much you owe

b. This month's bills arrive before last month's have been paid

c. You often owe late fees

d. All of the above

3. Decisions you can make that will help you pay down your debt include:

a. Canceling your credit cards

b. Opening a new, low-interest credit card account

c. Increasing your income and reducing your expenses

d. All of the above

4. How could you determine whether your debt load is more than you can afford?

(Correct answer: calculate your debt-to-income ratio)

5. So-called "good debt" is debt that helps to improve your________________.

(Correct answer: future self)

Strategies for Managing Debt

Directions: Divide students into small teams to complete this activity.

Part 1: Work with your team to fill out seven index cards, one for each of the following debts or loans. On each index card, write down an interest rate and loan amount based on the ranges provided below for each item.

- Auto loan index card: 0% - 20%, $1,000 - $10,000

- Credit card debt #1 index card: 12% - 34%, $250 - $15,000

- Credit card debt #2 index card: 12% - 34%, $250 - $15,000

- Credit card debt #3 index card: 12% - 34%, $250 - $15,000

- Mortgage index card: 4% - 5%, $100,000 - $300,000

- Payday loan index card: 300% - 450%, $350 - $500

- Auto title loan index card: 750%, $2,500 - $10,000

Part 2: On a blank piece of paper, tell students to write down an answer key that identifies the order in which they will repay their seven debts, using one of the following two repayment strategies. (Answers will vary based off of the loan amount that students give each loan. The loan payments should be ordered from smallest to largest loan amount.)

> **Debt Snowball Method:** This method of paying off loans works by prioritizing debts based on their size. By paying off smaller loans first, you'll be able to pay off several loans earlier on, and your payments "snowball" as you're psychologically rewarded. Many people feel more motivated to pay off loans if they can see visible progress.
>
> **Debt Avalanche Method:** Paying off debt through the debt avalanche method first means, making the minimum payment on each debt, then using any remaining money to start paying off the debt that has the highest interest rate. Once you've paid off your highest interest rate debt, tackle the debt with the next highest interest rate. Using this method can result in paying off debt more quickly while reducing overall interest rates.

Part 3: Tell students to swap cards with another team and compete. The team that can first correctly order its seven index cards for each strategy wins. As the facilitator, you hold each team's answer key and act as the referee.

Examining Debt Load

Directions: This activity can be done in small teams or individually by each student.

The sum total of all the money you owe is what's commonly known as your debt load. To determine whether students' debt load is more than they can afford, they should calculate their debt/income ratio by comparing the amount they owe to the amount they earn.

Part 1: Review John and Susan's personal finances:

- John has an average monthly income of $4,200 after taxes; a monthly mortgage of $1,100; and a consumer debt of $700.
- Susan has an average monthly income of $5,400 after taxes; a monthly mortgage of $1,700; and a consumer debt of $200.

Part 2: Read Understanding Debt Load on the Practical Money Skills website: practicalmoneyskills.com/ff41.

Part 3: Based on what you've read, calculate who has a better debt to income ratio: John or Susan. (ANSWER: Susan has a better debt-to-income ratio. She also has less consumer debt and is building wealth by paying a monthly mortgage to own her home.)

Glossary of Terms

Have students study this list of personal finance terms to warm up before playing Financial Football. By mastering these terms, students will have a better opportunity to answer questions in the game correctly and score.

Bad debt: Debt taken on for items that a consumer cannot afford and that does not generate opportunities for future income. (See good debt)

Bankruptcy: A condition of insolvency where an individual or business is unable to repay debts. Bankruptcy is a way to eliminate debts or repay them under court protection and supervision, although child support payments, alimony, fines, taxes, and some student loan obligations are typically not eliminated. Bankruptcy will stay on your credit report 7 or 10 years depending on the type of bankruptcy filing, possibly affecting your ability to buy or rent a home; it will also likely result in higher interest rates on future loans.

Collateral: This is an asset, like a property, that you may need to provide to a lender to get a loan. In many cases, collateral is required for certain types of loans, like mortgages and auto loans.

Cost-benefit analysis: Analyzing whether the cost of an item is more than, equal to, or less than the benefit that comes from its purchase.

Creditor: A person or business to whom money is owed.

Debt: The state of owing money to another individual or business, or the amount of money borrowed.

Debt avalanche method: Paying off debt through the debt avalanche method means first making the minimum payment on each debt, then using any remaining money to start paying off the debt that has the highest interest rate. Once you've paid off your highest interest rate debt, tackle the debt with the next highest interest. Using this method can result in paying off debt more quickly while reducing overall interest rates.

Debt counseling: This means debt management advice and services available through either of the following national organizations: American Consumer Credit Counseling, National Foundation for Credit Counseling.

Debt load: The sum total of all the money you owe.

Debt snowball method: This method of paying off loans works by prioritizing debts based on their size. By paying off smaller loans first, you'll be able to pay off several loans earlier on, and your payments "snowball" as you're psychologically rewarded. Many people feel more motivated to pay off loans if they can see visible progress.

Debt-to-income ratio: A calculation comparing the amount you owe to the amount you earn. Debt-to-income ratio may be used to see how much debt you can afford to take on.

Equity: In business, equity is a business's value and someone who has equity in the company owns part of the company. Two business partners who own equal parts of a business both have an equal amount of equity in the company. If the business is a corporation, the owner's equity is called shareholders' equity and shareholders receive shares or stock. Someone who owns half of the corporation's stocks owns half the company.

Finance: To borrow funds for the purpose of a purchase.

Glossary of Terms, cont.

Foreclosure: A legal process in which a mortgaged property is confiscated because the borrower has failed to keep up payments.

Good debt: The concept that sometimes it is worth taking on certain types of debt in order to generate opportunities for income in the long run. Some common examples of good debt include college education loans and real estate.

Liabilities: Everything that you owe, which may include your mortgage, credit card balance, interest, student loans, and loans from family and friends. The sum total of all the money you owe is what's commonly known as your debt load.

Loan: Money or assets borrowed and paid back with interest over time.

Loan principal: An amount borrowed that remains unpaid, excluding interest.

Loan term: The period of time during which a loan is active.

Mortgage: A mortgage is a loan needed to purchase a property; it includes three parts: a down payment, monthly payments, and fees. The monthly payment is the amount needed to pay off the mortgage over the length of the loan and includes a payment on the principal of the loan as well as interest. There are often property taxes and other fees included in the monthly bill. The fees are comprised of various costs you have to pay up front to get the loan. The down payment is the up-front amount you pay to secure a mortgage. The larger your down payment, the better your financing deal will be. You'll get a lower mortgage interest rate, pay fewer fees, and gain equity in your home more rapidly.

Mortgage payment: The payment a borrower makes each month toward the purchase of a home.

Mortgage term: The agreed-upon amount of time to pay off a mortgage.

Opportunity cost: The loss of potential gain from other alternatives when one alternative is chosen.

Principal: The amount of money you deposit in your account to begin saving, or the original amount of money borrowed.

Secured loans: For secured loans, which are often used for an influx of cash, you must provide collateral in the form of a liquid asset, like a savings account, or property. For example, once you have a car or home, you could use the property and your equity in it as collateral for a secured loan, giving you access to funds you can use for a number of things.

Student loan: A loan offered to students for education-related expenses that must be repaid.

Unsecured loans: An unsecured personal loan doesn't require you to put up any collateral (like a car) for the loan. If you don't repay it, the lender can't claim collateral as compensation. But there is something you risk if you default on either unsecured or secured loans — your credit. Lower credit scores could make it more difficult to get approved for other types of credit.