

Section 4: Manage your personal finance part II

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Class assignment#3 result

- ▶ Which financial institutions will you choose? Why?
- ▶ What do you learn from this assignment?

Choosing a source of credits

What kind of loan should you seek?

- ▶ **Inexpensive loans**
 - ▶ Parents or family members
 - ▶ Loans based on assets- using CD as collateral
 - ▶ Loans for finance education (from the U.S. Department of Education)
- ▶ **Medium-priced loans**
 - ▶ Commercial banks, savings and loan associations, and credit unions
- ▶ **Expensive loans**
 - ▶ Finance and check cashing companies
 - ▶ Retailers such as car or appliance dealers
 - ▶ Bank credit cards and cash advances

The cost of credit

- ▶ **Finance charge** is the total dollar amount you pay to use credit. It includes interest costs, service charges, credit-related insurance premiums, or appraisal fees
- ▶ The **annual percentage rate (APR)** is the percentage cost of credit on a yearly basis
- ▶ **APR:** True rate of interest so you can compare rates with other sources of credit. It is important to shop for credit.

The cost of credit (2)

- ▶ **Term versus interest costs.** Longer loans-lower payments, but more total interest
- ▶ **Lender risk versus interest rate.** Some ways to reduce the lender's risk and the interest rate:
 - ▶ Accept a variable interest rate
 - ▶ Provide collateral to secure the loan
 - ▶ Make a large down payment up front
 - ▶ Have a shorter loan term

Calculate the cost of credit

▶ **Simple interest**

- ▶ Computed on principal only and without compounding.
- ▶ The dollar cost of borrowing
- ▶ $I = P \times r \times T$

▶ **Simple interest on the declining balance**

- ▶ Interest is paid only on the amount of original principal not yet repaid

▶ **Add-on interest**

- ▶ Interest is calculated on the full amount of the original principal, added to the principal, and the total of both is divided by the number of payments to be made

Cost of open-ended credit

▶ **Adjusted balance method**

- ▶ Finance charges are calculated after payments made in the billing period have been subtracted

▶ **Average daily balance method**

▶ Creditors

- 1) add your balances for each day in the billing period
- 2) divide this total by the number of days in the billing period
- 3) multiply this average by the monthly interest rate.

- ▶ New purchases may be excluded from the average daily balance calculation, but generally are *included* if you carry over a balance.

Cost of open-ended credit (2)

▶ **Two-cycle average daily balance method**

- ▶ May include or exclude new purchases
- ▶ Creditors use average daily balance for two consecutive billing cycles

▶ **Previous balance method**

- ▶ Method of computing finance charges that gives no credit for payments made during the billing period

▶ For example...

- ▶ APR 18%; Monthly rate $1\frac{1}{2}\%$
- ▶ Previous balance \$400; Payments \$300
- ▶ Finance charge \$6.00 ($1\frac{1}{2}\% \times \400)

Cost of open-ended credit (3)

- ▶ **Inflation:** Borrowers and Lenders are concerned about the purchasing power of dollars, rather than the actual credit used.
- ▶ **Taxes:** Interest paid on consumer credit is not tax deductible.
- ▶ **Minimum Payment:** Avoid the minimum monthly payment trap.
- ▶ **Credit insurance:** Loan paid off if insured dies or becomes disabled--Expensive.

Managing your debt

Reasons for Debt

- ▶ Emotional problems such as the need for instant gratification
- ▶ The use of money to punish or get even
- ▶ The expectation of instant comfort among young couples who overuse the installment plan
- ▶ Keeping up with the Joneses
- ▶ Overindulgence of children
- ▶ Misunderstanding or lack of communication among family members
- ▶ Amount of finance charges makes it difficult to repay

Warning Signs of Debt Problems

- ▶ Paying only the minimum balance each month
- ▶ Increasing the total balance due each month
- ▶ Missing or alternating payments or paying late
- ▶ Intentionally using overdraft protection or taking frequent cash advances
- ▶ Using savings to pay routine bills such as food
- ▶ Getting second or third payment notices
- ▶ Not talking to your partner about money or talking *only* about money
- ▶ Depending on overtime to meet routine expenses

Warning Signs of Debt Problems (2)

- ▶ Using up your savings
- ▶ Borrowing money to pay old debts
- ▶ Not knowing how much you owe
- ▶ Going over your credit limit on credit cards
- ▶ Having little or no savings for the unexpected
- ▶ Being denied credit due to a credit report
- ▶ Getting a credit card revoked by the issuer
- ▶ Putting off medical or dental visits because you can't afford them now

Consumer purchasing strategies

Financial implications of purchasing decisions

- ▶ **Commonly overlooked trade-offs when buying include...**
 - ▶ Paying a higher price over time by using credit to buy items you need now.
 - ▶ Buying unknown, possibly poor-quality brands, that are less expensive.
 - ▶ Selecting brands that may be difficult to service or repair.
 - ▶ Ordering by mail or online to save time and money, but return or repair may be difficult.
 - ▶ Taking time and effort to comparison shop.

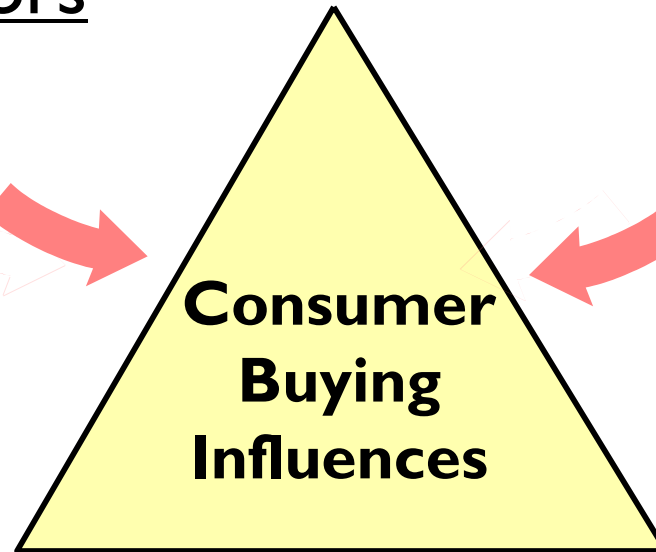
Factors of consumers purchases

Economic Factors

- ◆ Consumer prices
- ◆ Interest rates
- ◆ Supply/demand
- ◆ Brand name
- ◆ Warranty
- ◆ Product Quality
- ◆ Tax rates
- ◆ Govt. regs.

Social Factors

- ◆ Lifestyle
- ◆ Culture
- ◆ Attitudes
- ◆ Ads
- ◆ Media/Internet
- ◆ Hobbies
- ◆ Peer group



Personal Factors

- ◆ Sex and age
- ◆ Marital status
- ◆ Occupation
- ◆ Income
- ◆ Education
- ◆ Family size
- ◆ Housing type
- ◆ Ethnic group
- ◆ Religion

Practical purchasing strategies

- **Timing purchases**
 - ▶ Be aware if the price varies with the time of the year

- **Store selection**
 - ▶ Choice of retailer depends on location, price, product
 - ▶ Cooperatives -non-profit organization; members save money

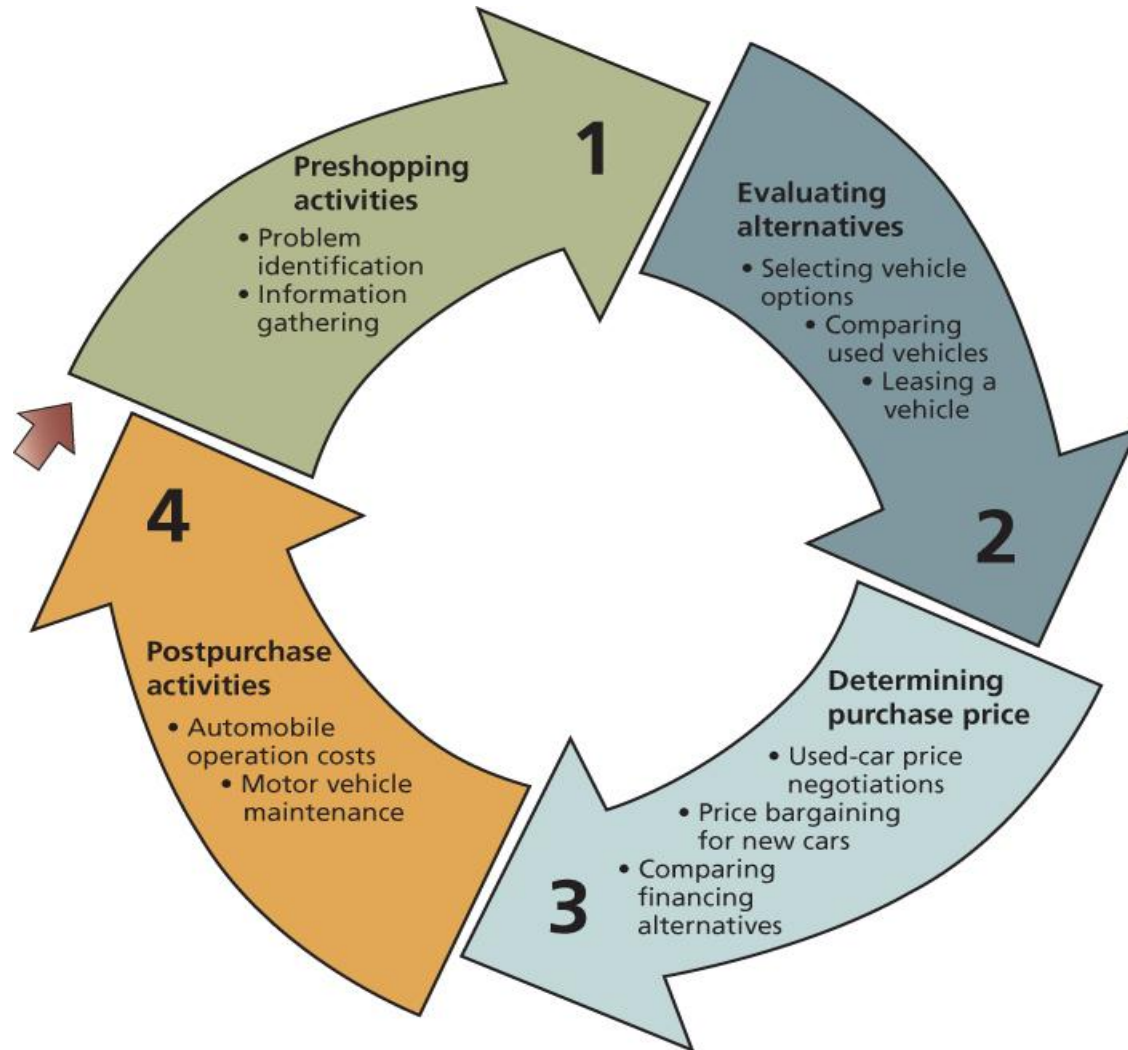
- **Brand Comparison**
 - Comparison shopping of store and national brands; avoid impulse buying (unplanned purchasing)

- **Label information**
 - Look for information on label and open dating

Practical purchasing strategies (2)

- ▶ **Price comparison**
 - ▶ Unit pricing provides a standard of measurement
 - ▶ Coupons (online: coolsavings.com; centsoff.com; couponsurfer.com) and rebates (partial refund)
 - ▶ Convenience & ready-to-use products may mean higher prices. Large is not always the best buy, and “Sale” prices vary among stores
- ▶ **Evaluate warranties**
 - ▶ Full or limited express warranties, usually written.
 - ▶ Warranty of Title-the right to sell the product
 - ▶ Implied warranty of merchantability-fit for normal use
- ▶ **Service contracts -also called extended “warranties”**

An illustration: Buying motor vehicles



Buying motor vehicles (2)

Phase I: Pre-shopping Activities

- Problem identification
- Information gathering
 - ▶ Personal contacts
 - ▶ Business Organizations
 - ▶ Media information-television, Websites
 - ▶ Independent testing organizations- Consumer Reports
 - ▶ Government agencies.
 - ▶ Online Sources

Buying motor vehicles (3)

Phase 2: Evaluation of Alternatives

- ▶ Comparison shopping
- ▶ Selecting vehicle options-convenience, appeal, etc.
- ▶ Comparing used vehicles
- ▶ Leasing an automobile
 - ▶ lower payments, smaller initial cash outlay
 - ▶ no ownership in vehicle

Buying motor vehicles (4)

Phase 3: Determining Purchase Price

- ▶ **Negotiation for New and Used cars**
 - ▶ Know necessary information about the product
 - ▶ Deal with a person of authority to give you a lower price or additional features.
 - ▶ Used-cars: Check newspaper ads, Kelly Blue Book
 - ▶ New cars: Set-price dealers, car-buying services

Buying motor vehicles (5)

Phase 3: Determining Purchase Price (continued)

- ▶ Compare financing alternatives
 - ▶ Variety of lenders-some lenders may pre-approve you
 - ▶ Avoid being upside-down or having negative equity in your car
 - ▶ Look for rebates or low-interest financing.
 - ▶ Consider the APR, total finance charge.

Buying motor vehicles (6)

Phase 4: Post-purchase Activities

- Lemon Laws
- Automobile operation costs
 - Use the item correctly to have improved performance and fewer repairs
 - Investigate, evaluate and negotiate a variety of servicing options
- Motor Vehicle Maintenance
 - Operation costs; fixed and variable expenses
- Automobile servicing sources; dealers, service stations, garages, Wal-Mart, etc

Class assignment 4

Consumer purchase decisions



Consumer purchase decision

First, choose the product of your choice (e.g., laptop, tennis racket, television)

| | | | |
|---|--|-----------------|--|
| Product | | | |
| | | | |
| Exact description (size, model, features, etc.) | | | |
| | | | |
| Research the item online and in consumer periodicals for information regarding you product | | | |
| article/periodical | | Web site | |
| | | | |
| date/pages | | date | |
| | | | |
| What buying suggestions are presented in the article? | | | |
| | | | |
| Which brands are recommended in these articles? Why? | | | |
| | | | |

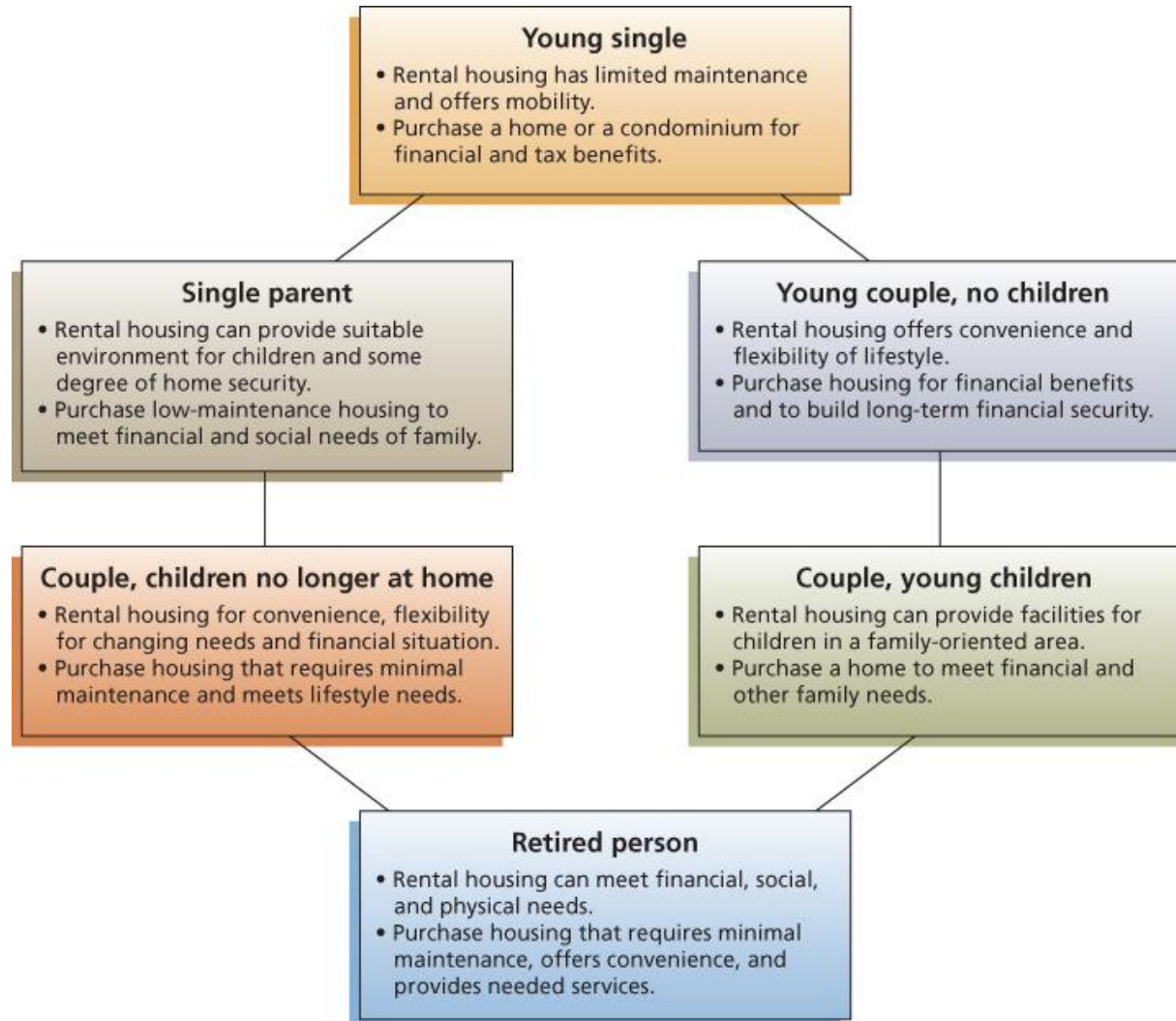
Consumer purchase decision (2)

Contact or visit two or three stores that sell the product to obtain the following information:

| | Store 1 | Store 2 | Store 3 |
|---|---------|---------|---------|
| Store name | | | |
| Address | | | |
| Phone/Web site | | | |
| Brand name/cost | | | |
| Product difference from item above | | | |
| Warranty (describe) | | | |
| Which brand and at which store would you buy this product? Why? | | | |

Housing decisions: factors and finances

Housing alternatives by life stages



Housing alternatives

- ▶ Your lifestyle and your choice of housing
 - How you spend your time and money, affects your housing choice.
 - Personal preferences are modified by financial factors.
 - ▶ Traditional financial guidelines suggest you spend no more than 25-33% of take-home pay on housing, or no more than 2 1/2 times your annual income.
- ▶ Opportunity costs of housing choices
 - ▶ Interest earnings lost on money used for a down payment or the interest on a security deposit for an apartment
 - ▶ Time and cost of commuting to live in an area that offers less costly housing or more space

Renting your residence

- ▶ The search
 - ▶ Select an area and rental cost for your needs
 - ▶ Compare costs and facilities between units
 - ▶ Talk to current and past residents

Renting your residence (2)

- ▶ Advantages of renting
 - ▶ Easier to move
 - ▶ Fewer maintenance and repair responsibilities
 - ▶ Lower initial costs

Renting your residence (3)

- ▶ Disadvantages of renting
 - ▶ No tax benefits
 - ▶ Limitations regarding remodeling
 - ▶ Restrictions regarding pets and other activities
 - ▶ Legal concerns of a lease
 - ▶ Costs including a security deposit, utilities and renter's insurance

Legal details of a lease (2)

- ▶ Date and amount for late rent payments
- ▶ List of included utilities, appliances
- ▶ Restrictions on certain activities
- ▶ The right to sublet the unit
- ▶ Conditions where landlord may enter rental unit

Home buying process

Step I: DETERMINE THE HOMEOWNERSHIP NEEDS

- ▶ *Benefits of Home Ownership*
 - ▶ Financial benefits
 - ▶ Deduct property taxes and mortgage interest
 - ▶ Potential increase in value of your home
 - ▶ Building equity in your home
 - ▶ Lifestyle flexibility - express your individuality

Home buying process (2)

- ▶ *Drawbacks of Homeownership*
 - ▶ Financial uncertainty
 - ▶ Obtaining money for the down payment
 - ▶ Obtaining mortgage financing
 - ▶ Home values could drop
 - ▶ Limited mobility
 - ▶ Can take time to sell your home
 - ▶ Higher living costs
 - ▶ Home improvements
 - ▶ Rising real estate taxes

Home buying process (3)

- ▶ Assess Types of Housing Available
 - ▶ Single-family dwelling
 - ▶ Multi-unit dwelling
 - ▶ Duplex, townhomes
 - ▶ Condominium
 - ▶ You own your unit in a building of units
 - ▶ It is not a type of building structure, but rather a form of homeownership

Home buying process (4)

▶ Building a home

- ▶ Does the contractor have needed experience?
- ▶ Does contractor have a good working relationship with architect, suppliers, electricians, plumbers, carpenters and others?
- ▶ What assurance do you have about quality?
- ▶ What are the payment arrangements?

Home buying process (5)

- ▶ **Building a home (continued)**
 - ▶ What delays will be considered legitimate?
 - ▶ Is the contractor licensed and insured?
 - ▶ Are there any complaints about this contractor?
 - ▶ Contract should have a time schedule, cost estimates, description of work, and a payment schedule.

Home buying process (6)

Step 2: FIND AND EVALUATE A PROPERTY TO PURCHASE

- ▶ **Selecting a Location**
 - ▶ Be aware of zoning laws
 - ▶ Assess the school system if you have children.
- ▶ **Using a real estate agent**
 - ▶ They present your offer, negotiate the price, assist you in obtaining financing, and represent you at the closing
- ▶ **Conduct a home inspection or hire an inspector**

Home buying process (7)

Step 3: PRICING THE PROPERTY

- ▶ **Determine the Home Price**
 - ▶ Price is affected by whether it is a seller's or a buyer's market.
- ▶ **Negotiating the Purchase Price**
 - ▶ Counteroffers are common
 - ▶ Earnest money
 - ▶ Contingency clauses, such as...
 - ▶ Buyer must be able to obtain financing
 - ▶ Sale contingent on the sale of the buyer's current home

The finance of home buying

Step 4: OBTAIN FINANCING

- ▶ Determine the amount of the down payment
 - ▶ Mortgage insurance (PMI) if less than 20% down
- ▶ Investigate the rates, types, & terms of mortgages
- ▶ Apply for a mortgage and evaluate types of mortgages. Guidelines for affordability of housing costs are 33% to 38% of gross income

The finance of home buying (2)

▶ Qualifying for a mortgage

- ▶ includes your income, debts, credit history, down payment amount, length of the loan, and current mortgage rates
- ▶ Step 1: Prequalification
- ▶ Step 2: Finding a property, including appraisal
- ▶ Step 3: Fee Payment and commitment

Fixed-rate, fixed-payment mortgages

▶ Conventional

- ▶ Fixed rate, fixed payment, amortized
- ▶ 5%, 10% or 20% down
- ▶ 15, 20 or 30 years of fixed payments

▶ Balloon

- ▶ Fixed monthly payments plus one large payment, usually after 3, 5 or 7 years

Adjustable-rate, variable-payment mortgages

- ▶ **Adjustable rate mortgages**

- ▶ During the life of the loan the interest rate varies with the prime rate, but has a rate cap
- ▶ A payment cap may limit the payment but, extend the loan

Mortgage calculate spreadsheet

- ▶ Excel added

Other financial methods

▶ Buy-Downs

- ▶ Interest subsidy from a home builder or a real estate developer that reduces the mortgage payments for the first few years

▶ Second mortgage

- ▶ Home is collateral and interest may be tax deductible. Home equity loans are an example

▶ Reverse mortgages

- ▶ Provides elderly (>62 years old) with tax-free income based on the home equity

▶ Refinance if interest rate drops at least 1%