FN221 PERSONAL FINANCE GROUP ASSIGNMENT

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EXERCISE:

David and Elizabeth Brown want to borrow $60,000 to upgrade their shop. The business has a net worth of $200,000 at present. Their house is currently valued at $650,000 and they still owe $220,000 on it. They also want to take Jim on an overseas holiday to Hawaii before he is too old to travel with his parents. Jason needs money for a car to get to University, Tarini needs money to buy her first home and Jim wants to borrow to buy a new smartphone this year.

1)

Persons	Amount needed and purchase	Reasons for borrowing	Reasons against borrowing	Recommended form of credit and reasons for choice
David **Elizabeth**	- Upgrade their shop $60,000 - Owe $220,000 for house loan valued at $650,000 - Hawaii Trip $4656.39 Hilton Hawaiian Village Waikiki Beach Resort (1/10/14 – 10/10/14) - 9 nights 1 room	Borrowing to invest is always a good idea if you know there is higher return waiting for you Get Tax benefits for interest expense Good Choice to finance capital items, saving you cash for day to day operations If you are sure you have a solid income and are capable of paying the debt back, you can borrow for vacation that you dream of because you only live once	- you can use your savings for other uses, like retirement and a rainy day fund or mortgage -Needs collateral, Brown family might have to use their house as an asset, which is dangerous to tie business and the place you live in together - An example of bad debt: A luxury holiday can be a trip of a lifetime, but is best avoided if it's accompanied by a lifetime of debt. Instead of getting into debt, try and save up first, if necessary reworking your plans so you can still take a holiday, but one you can afford	**CLOSE END CREDIT** Upgrading shop - Installment cash credit – direct loan of money for personal purposes – home improvements No down payment and make payments over a set period. Installment sale credit - for owed house mortgage Hawaiian trip – Installment cash credit (direct loan for personal purpose, no down payment)
Jim	- Smartphone $649 w/o monthly plan (iPhone 5s) Prepaid - Smartphone $627 w/ monthly plan contract	- Jim can learn to manage his money properly by using his parent's credit to pay instalments for an IPhone 5s and pay his parents back monthly T-Mobile is offering it up front for $99 plus $22 a month for 24 months.	- An example of bad debt, because it is like borrowing money to pay your bills - If they were unable to get 0% interest instalments, they will have to pay more than actual price	**OPEN END CREDIT**: loans are made on a continuous basis and the borrower is billed periodically for at least partial payment (POST PAID PLAN) **CLOSED END CREDIT: Instalment sale credit:** for phone instalment
Jason Job: Part Time Job earning roughly $900	Car to university Used Toyota Prius Vehicle Price: $24995 Down Payment: $3995 APR: 2.75% Term: 48 months Monthly Payment: $462.5	= Allow you to pay in monthly installment in which as times pass your income would increase --> lessen the burden on the consumer as the installments are the same. - Allow you to save for any future mishap and selecting wilder model range.	- raising the total cost of the car above the sticker price. - poor credit results in a higher interest rate and higher monthly payments (Jason is still in university) - you may also need to purchase gap insurance to make up the difference in the event of a total loss. a vehicle repossession puts a black mark on your credit history than can last for several ars.	**CLOSED END CREDIT** **Installment sale credit** (Down payment and usually sign a contract to repay the balance plus interest and service charge in equal installments over a specific period)

Tarini Job: Mechanical Choice: Buy a house for tax and financial benefits (Young Single) Salary Monthly: $6564 After Tax: $4977.62 ASSUME: No Auto Loan Affordable Mortgage payment: 1,342.61 (1342.61/5)*1000= 268,522,92 4.34% 30y Affordable Home Purchase Price = 280,705.5	$1,409 monthly 30 years 4.47% Asset Type: Location: 1850 N Clark St Chicago, Illinois 60614 Real Estate Agent: Prudential Rubloff Properties Posted Price: $275,000 Down Payment: $55,000	- A mortgage can be a **good debt**. Once that mortgage is paid off, that home will be a **big financial asset**, which is likely to grow in value over time and the monthly mortgage payments could be cheaper than rent. - Tarini does not have enough savings and asset to purchase a house without loan - Getting a home mortgage gets you **tax break**, every $1 you spend in interest payment you get 35% tax break - Return on your investment that is much more reliable than anything the stock market can offer. It provides the security of having an affordable place to live, in the event that your income declines.	- **Impact of future interest rate rises** and will restrict how much you can borrow if it looks as if you wouldn't be able to afford the mortgage if rates went up. (FHA provides steady interest rate) - You **pay more than the actual price** of the house, due to amortization schedule - The longer period your mortgage is, the higher total cost of your home	**CLOSED END CREDIT** **Installment sale credit** (Down payment and usually sign a contract to repay the balance plus interest and service charge in equal installments over a specific period) FHA/VA Fixed- rate mortage (open end credit) has low down payment, less strict credit requirements, and can benefit from FHA's 203(k) mortgage insurance program Guarantor Mortgage: a parent or close family member guarantees the mortgage debt. This means that if the buyer misses their mortgage repayments the guarantor will have to cover them.

Assume: According to the 1990 United States Census, Brown is the fifth most common family name in the United States at 0.621% of the sample population.

**** References is printed

2) Given the Brown family will need to get credit for this holiday, investigate the issue of credit rating for them. Outline the factors that affect the personal credit rating.

Assuming that the Brown family will need to borrow $5000 installment cash credit. As a bank, we need to consider 5Cs, which are Character, Capacity, Capital, Collateral, Conditions and also National Credit Bureau Report. Moreover, we have to consider their Debt Payment to Income Ratio, Monthly debt payment (exclude house payment) to Monthly Income ratio and Debt to Equity Ratio. By looking at these factors, bank will be able to analyze whether Brown should get the credit or not.

- Debt to Equity Ratio:
  Debt to Equity Ratio of Brown family is not that high. From recommendation, it should not exceed 0.5
- Debt payment to Income Ratio: 3,583.33 0.43 or 43%
  Brown still have to pay a lot of debt and the income is varying meaning that their debt payment to income ratio is not good because it is too high, 43%. (Calculation based on assumption that, they have to pay 3,583.33 monthly and their income is 8,333.33 monthly). In order to have good credit, debt to equity ratio should not exceed 20%.
- Character: Will Brown be able to repay the loan?
  - Do they pay their bills on time?
    Assuming that they pay their bills on time
  - Has they used credit before?
    Yes, they use it before such as on house
  - Has they ever filed for bankruptcy?
    No
  - Do they live within their means?
    Assuming that they do live within their means
  - Do they own their own home?
    Yes, but have not yet repaid the entire loan
  - How long have they lived at their current address?
    Assuming that they have lived in this house for more than 10 years
  - How long have their been employed by their present employer?
    They have owned the shop (Self-employed), which open more than 15 years.

  We can see that their character is well profiled. However, bank need to consider other factors as well.
- Capacity: Can Brown repay the loan?
  - What are their jobs and what are their salaries?
    The parents are the shop owner assuming their income is unstable but range around $70,000 - $150,000
  - How reliable is that income?
    Their income is depending on how well they can sell. Their annual income is range from $70,000 to $150,000
  - Does they have any other sources of income?
    No
  - How many dependents does they have?
    None
  - What are the other claims on their income?
    They have to pay for housing mortgage loan every month.
  - What are their current debts?
    They have housing mortgage loan.

  They have pretty high capacity to repay the debt despite the future loan on upgrading their shop.

- Capital: What are their assets and net worth?
  - Brown needs to list the value of all of his assets
    Shop worth $200,000 and house worth $650,000.
  - Brown needs to list the value of all of his liabilities
    Housing loan $220,000

- Brown can then calculate their net worth
  - Their net worth is $630,000

They have enough capital to cover up their debt although they are going to borrow more.

- Collateral: What if they do not repay the loan?
  - What assets can Brown use to secure the loan?
    - They can use shop or house to secure the loan.
  - Do the assets used to secure the loan have any warranties/guarantees?
    - No
  - Do the assets used to secure the loan have sufficient insurance?
    - No
  - What is the age of the assets used to secure the loan?
    - Shop – 10 years and House – 5 years
  - Are there any claims to the title of the assets used to secure the loan?
    - No
  - What sources does they have besides income (savings, stocks, bonds, insurance, etc.)?
    - None

They only have house and shop to guarantee the loan. However, the value of these assets is way too much for this loan.

- Conditions: What general economic conditions can affect their repayment of the loan?
  - How secure is their job?
    - They are self-employed so their job is very secure.
  - How secure is the shop that they work for?
    - They have opened their shop for more than 15 years, so their shop is quite well known and reliable. Therefore, it is very secure.
  - What is the condition of the industry that Brown is employed in?
    - The condition of the shop that Brown's own is in a good condition since they have planned to upgrade their shop in the near future.

In good economic conditions, Brown's shop can operate well and they have very low risk of losing profit.

After the bank have considered all these values, Brown have high tendency to get this loan since the amount of loan is very little comparing to their total assets and other loans. Although Brown still has some debt like housing debt but after all, Brown's net worth is positive. However, the Brown family has to take into account of their future loan on Jason's car and Shop upgrading in order to borrow the money.

3) For the comparison, buying an iphone5s without any contact will cause about $649. In short, what you only get is a single phone. However, Buying a phone with contact from t-moblie will get you both the phone and contact with the cost of $99 and paying a contact of22 a month for 24months (2years). So what you actually get to buy is 99+22(24) = $627. The difference of buying only a phone without contact and a phone with contact is 649-627 = $22. This amount may not seem to be large; however, you get to have both phone and contact within 2 years with the price lower than buying a single one without contact which is a paramount benefit. If you are interested to buy only a phone and contact separately, the minimum contact that you will get to pay is $100 per year with 1000minutes, in the average, it is about 10cent/minute. Hence, buying two years contact and iphone5s separately will cost you $849 which is far more expensive than buying with contact for about 849-627= $222.(From the $100per year contact, this is a contact of least minimum cost which has been considered from all of the contact service provided).