

Assignment 3

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 smart phone this year.

Assumption: A

- David and Elizabeth have only one source of income which is their business.
- David and Elizabeth rated as good credit client, have historical credit data, thus, loan from commercial bank at low interests rate.
- Tarini is employed, still single and stable career path
- Jason receives scholarship and takes part-time job. He value time more than other factors.
- Jim is in primary school: free education. And about to enter high school. Have no saving.
- Brown family living in New York City

Assumption: B (holiday trip)

- Only David, Eliza, and Jim go for holiday.
- 3 days and 2 nights trip
- Enjoy luxury life style

Brown members	Amount of needed and purchase	Reasons for borrowing	Reasons against borrowing	Recommended form of credit and reasons for choice
David and Elizabeth	\$60,000	Upgrade their shop. The rate of return in investing may more than the rate of borrowing. Shop expansion will provide more area for goods and services. Revenue increase in a greater rate than expenditure.	Consider whether the return will be worth or not if they upgrade the shop. The operating cashflow will be affected. Borrowing associate with risk, they need to pay cash on hand for the interests, Which affect their ability to pay.	Installment cash credit because they use money for business purpose. Even though the loan is considered a small, however, it associates with risk in paying the full amount. Therefore, to minimize risk, they can repay monthly to avoid liquidity problem.
David and Elizabeth (Holiday trip)	\$3419 including all expenditure Airplane ticket -\$873*3= 2619 Hotel -\$500 Pocket Money -\$300 (Assuming they	-Take Jim on an overseas holiday to Hawaii. It is important to spend time with children before they enter teenage life. - There are tendency that they	-Borrowing doesn't generate income. They could use saving instead. - Tendency to max out the credit limit, thus, in order to control their overspending	Revolving credit purpose because they will frequently make a purchase. They don't know exact amount of total loan need. Plus, the borrowing amount is small, the

	live in New York and the trip members are David, Elizabeth and Jim.)	might overspending with their current saving, thus, borrowing can be alternative solution to reduce budget constraint.	behaviour, their max budget spending must equal to their maximum saving.	interest charged is affordable.
Jim	\$ 199 iPhone5s with 2 years-contract(post-paid)	He can enjoy benefits of smart phone (its applications and functions). Keep in touch with his primary school friends.	- He has no income and cannot pay the loan by himself - Smartphone is an unnecessary item which cannot generate any income.	As we assume that he does not have any saving. It would be better if his parents afford it and he can pay back later. Cost burden pushed to parent
Jason	\$16,042.80 (Assuming he is going to buy an used car, price is included tax and vat.)	-Jason can use the car as collateral. Purchase a car due to the convenience in transportation to university. As he value time more than other factors, personal car is favourable because he reduce time spend on travel and more to study. -Part time jobs for future benefits	- He can save his budget for investing or doing business. - It will be overspent due to fuel cost, maintenance cost since it is second hand car. - He also has to take in account depreciation of the car.	Installment sale credit because car is huge asset, this credit make him pay small amount per month which is affordable. It is one time purchase, so it doesn't need revolving.
Tarini	\$200,000 in house price, with 10% down payment.	- Buy first home for her future if she has a family. In addition, invest in house is similar to long term investment. If she invest today the price of the house will be cheaper than tomorrow price. Plus, house noted as collateral. She can buy a house that close to her working place	-House is not that necessary when she hasn't married. -The mortgage loan associate with risk. For instance, if she missed monthly payment for many periods the bank have the right to take away her house. -She can save up money to invest in the future.	Installment sale credit because house is huge asset, this credit make her pay small amount per month which is affordable. It is one time purchase, so it doesn't need revolving.

		which could save time and money spent on transportation.		
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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.

In order to get credit, Brown has to think about their credit rating through 5Cs.

Character

- Brown family owns their shop as well as their house, worth 650,000, owed 220,000.
- The business assumed to have good credit will bank. Since they are certainly take loan from the bank to open the shop.
- They are good behavior client. No exposure to moral hazard behavior.

Capacity

- Brown family has to take note on their revenue, ability to repay loan.
- Debt: 220,000/ Net Worth: 200,000
- The Brown's business does not have any other source of income. Currently, their debts amount \$220,000 and Net worth amount \$200,000
- Debt to Equity ratio = $L / \text{Net worth} = 220000 / (650000 + 200000 - 220000) = 0.35$
- According to the Lecture, recommended debt ratio, should not exceed 0.5, thus in this case the debt ratio condition is favorable.
- Brown family has 2 dependent, Jason and Jim.

Capital

- Brown asset: House and Shop whereby, the value of the shop is unrevealed. House valued \$650,000. Similarly, Brown's business earn an profit, net worth amount 200,000
- However, Brown family is in debts of \$220,000, accounted liability.
- Thus, Net capital= $650,000 + 200,000 - 220,000 = 630,000$

Collateral

- Asset holding: House and Shop, valued 650,000 and unrevealed, respectively.
- The asset currently holding is sufficient to pay the loan
- Case1: Use house as collateral. The Bank will rated Brown family premium client since the value of the asset guarantee the ability to pay back the loan. However, in bank will ask the client to insure the safety of the asset in case of unexpected event such as natural disaster, or terrorism.
- Case2: Do not use House as collateral. Assume that Brown family is confident in repayment. The value of the house exceeds the amount of loan. $\text{House} > \text{Loan}$. Thus, it is not favorable to use house as collateral.

Condition

- Since they own business, we assume that before upgrading the shop they earn constant income, thus, the upgrading will certainly increase their sales. However, there is tendency for bankruptcy.
- Plus, they need to concern on their security level and financial status of their business.

In conclusion, Brown family should borrow because the opportunity cost in borrowing is high. The present expansion of business will provide an opportunity in boosting their revenue.

Compare the costs of prepaid phone cards as against signing a mobile phone contract.

	Advantage	Disadvantage
Pre-paid	1)Overall cost are cheaper than the post-paid one. (About \$1,370 pre-paid and at least \$2,360 post-paid) 2)Monthly payment is affordable and reasonable.(\$35/month)	1)Need to pay huge amount (\$650 for iPhone5s) at the beginning.
Post-paid	1) Pay less amount at the beginning (\$199 with 2 years-contract) 2) Save up budget for other financial activities	1) During 2 years-contract, the monthly payment cost too high for a student. (\$90/month)

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