



# Chapter 8-Section 2

Long-Term Debt Repayment

# Long-Term Debt

- A loan that is payable over a period longer than a year with monthly equal payments.
  - Examples: car loans, mortgages and loans to purchase small businesses
- Amortization-the process of dividing up your debt obligation, plus interest, into equal monthly payments over a set period of time.
- Installment Loan-a loan with monthly equal payments.
- Upside-down loan-when more is owed on the item than it is actually worth, example: house, car

# Buying a Car

- A car loan is an installment loan with monthly payments
  - Down payment—a cash deposit toward the purchase price—reduces the amount of the loan
  - Trade-in—Using the value of an existing car and applying it as a down payment towards a new car purchase—reduces the amount of the loan
- Cars depreciate—go down in value (depreciating asset)
- Loans are structured to be paid off faster than the car depreciates

# Financing Options-Preapproved Loans

- Preapproved loan-a maximum amount that is established and approved in advance by a credit union or bank
  - Loans are offered in increments of 36, 48, 60 or 72 months
  - A longer term loan means lower monthly payments—which means you will pay **MORE** interest on the loan.
  - A shorter term loan means higher monthly payments—which means you will pay **LESS** interest on the loan.

# Financing Options-Dealer Financing

- Car dealers often have new car financing options
- Special deals are offered particular times during the year
- Loans as cheap as zero percent interest

# Car Lease

- Allows use of a car for a set period of time
- Monthly lease payment (you do not own the car)
- Lease payments are typically lower than a car loan payment
- Lease payments only cover the value of the car used during the lease period
- Lease terms:
  - Down payment
  - Limited to a certain number of miles driven annually
  - Miles over annual limit are charged at a set amount per mile
  - End of lease offers an option to buy the car
  - Responsible for routine maintenance
- Leasing allows you to drive a nicer vehicle than you would otherwise be able to afford

# Debt Repayment

- Monthly payments include principal and interest
  - Payments are broken down with a portion going to pay interest and a portion going towards loan principal
    - Example: Payment of \$650- \$350 goes to interest and \$300 goes to principal
- Payments decrease the amount of the loan
- Early payments may help save in interest costs
- Paying extra helps reduce the life of the loan and interest costs
- Refinancing-involves paying off the old loan with a new loan
- Refinancing is done to improve loan options
  - New loan has better terms and a lower interest rate

# Buying a House

- A house is an appreciating asset (grows in value)
- Market value-the highest price that property will bring on the open market
- As a house loan is “paid down” it builds equity
  - **Equity**-the difference in the property’s value and what is owed on it
- Tax advantages
  - Deduct interest paid on a house loan on Federal Income Return
  - Energy credits for improvements
  - Property Tax deduction (if you itemize)
- Owning a home offers:
  - Security, independence, privacy, demonstrates responsibility



# Financing Options-House

- **Mortgage-loan**-term debt agreement used to purchase a home
  - Property is collateral
  - Types of Loans
    - Conventional Loan-large down payment, monthly payments for up to 30 years (also available in 15 and 20 year loans)
    - FHA Loan-government sponsored loan, small down payment, monthly payments—loan is insured through government, which requires a mortgage insurance premium
      - Less risky for banks to loan money, because insured by government
    - Closing Costs-title insurance, appraisal fees, credit reports, loan origination fees and recording costs
  - Expenses after purchase-taxes, insurance and repairs

# Debt Repayment Plan

- A strategy for paying off debt in a way that reduces the total interest paid.
- Paying extra each month with your monthly payment will bring debt down faster
  - Example: House payment of \$600, adding just \$50 extra month to the principal payment will reduce the life of the loan by 4.5 years.
- Focus on debts with highest interest rate

# Student Loan Debt

- **Deferred-payment loan**-postponing payments until education is completed
- **Subsidized student loans**-backed by the government and will not accrue interest until you have graduated and start making payments
- **Unsubsidized student loans**-these start accruing interest from the time the loan is taken out
- **Consolidate loans**-get a new loan to pay off all existing loans
- **Loan forgiveness**-a program by the federal government to encourage young people to consider “giving back” to society by performing public service

# Prepayment Penalty

- A fee charged if you repay a loan before the agreed-upon time
  - Repaying a loan early, may still be a wise choice if the penalty is less than the interest saved by paying early
  - Investigate and be sure you understand your prepayment penalties
- Paying a loan off early improves your credit score and frees up cash to be used for other purposes