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Managing money
Film: Borrowing money

Worksheet 16

What loan is suitable for what?

It's really very simple. You can spend your money or save it. And generally speaking, people save money in order to spend it later.
But sometimes, you need something before you have enough money for it. And that is where the order changes: you spend money first and have less to spend later because you have to pay back the money you borrowed. So the reverse applies: spend first – then save.

There are three important aspects to the subject of loans.

- Is it even advisable to take out a loan to finance a planned expenditure? A loan can make sense if you wish to fund a large one-off expense.
- Am I able to repay the loan at all and can I repay it within the agreed timeframe? Someone who receives just €20 pocket money a month cannot possibly repay a €20,000 loan over two years.
- Have I selected the right form of loan or am I potentially paying too much interest on the money I have borrowed? Overdraft facilities and instalment loans are designed with different purposes in mind.

1. The following section looks at various situations. Decide whether a loan should be taken out and, if so, what type of loan is suitable.

No	Situation	Loan yes/no	Overdraft facility	Instalment loan
1	The car is at the garage for repairs. The garage bill is higher than the balance on your account.			
2	You spent too long in a phone call whilst abroad. Your mobile phone bill is higher than usual this time.			
3	The washing machine has broken. You urgently need a new one.			
4	You want to make holidays somewhere warm over Christmas. But you need an extra €300.			
5	The all-inclusive flat rate tariff costs €10 more than you have at your disposal every month.			
6	The young man in the film wants to rent a larger flat; he wants to use a loan to pay the rent.			
7	A school kid's new superbike has been hit by a spaceship and now they need a new one. The kid has no more savings.			
8	A fantastic jacket is being sold for half price in the sales. It now costs just €299, reduced from more than €500. A clear case for a loan – or is it?			

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2. To get a feeling for interest, put a cross next to the amount that you think you would have to pay back if you borrowed €1,000 for five years at the interest rates given. Then check your assumption and enter the result in the last column. You can do this using an online interest calculator, for instance:

   https://www.bankrate.com/calculators/mortgages/loan-calculator.aspx

Interest rate	a.	b.	c.	d.	e.
5%	1,053	1,102	1,132	1,180	
10%	1,150	1,192	1,236	1,275	
20%	1,374	1,590	1,682	1,712	

3. You want to borrow €1,000 and pay back the loan over three years.

   a) Look at the four offers and decide which one you would choose. Give reasons to support your answer.

	Offer 1	Offer 2	Offer 3	Offer 4
Interest rate	4% nominal p.a.	6.6% nominal p.a.	5% nominal p.a.	5% nominal p.a.
Amount paid out	95%	100%	100%	100%
Processing fee	0	0	3% of the initial loan amount	€15 p.a.
Instalment per month	€29.53	€5.50 (interest) Repayment in full upon maturity	€30.87	€30.43

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When considering a loan, people will naturally always look at the interest rate first. However, if you take a closer look at loan offers, you may have noticed that sometimes just one percentage, marked “APR”, is listed (e.g. 2.5%).

“APR” stands for “annual percentage rate”. This refers to the interest rate including all other costs, say processing fees or a disagio, in other words a discount on the loan amount which the lender deducts. The annual percentage rate can be considerably higher than the nominal rate.

b) Listed below are the annual percentage rates for the individual loan offers. Are you sticking with your choice? Explain your decision!

	Offer 1	Offer 2	Offer 3	Offer 4
Annual percentage rate	7.70%	6.80%	7.36%	6.20%

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