DANGERS of DEBT

CH 4

What do other high school students know about debt?

We asked high school students if they or someone they knew ever bought something they couldn't afford.

> "My mom bought a new car and couldn't afford the payments. **The bank repossessed the car.**"
>
> Junior, Michigan

"My friend bought a new car and had to sell it one month later."

Junior, Tennessee

"I used all my money on an iPod and had none left for gas. I had to borrow money from my parents so I could make it to work."

Senior, Missouri

"My cousin bought a really expensive car and she can't make the payments"

Junior, Alabama

"A friend bought a car he couldn't afford. After making only a few payments, the car got repossessed."

Junior, Missouri

LEARNING OUTCOMES

Analyze the history and evolution of credit.

Demonstrate the various ways people get into debt.

Compare and contrast credit cards and debit cards.

Explain how the debt snowball works.

Evaluate and refute the myths associated with debt.

KEY TERMS

Annual Fee
Annual Percentage Rate
Credit
Debt Snowball
Depreciation
Tax Deduction

BEFORE YOU BEGIN

What do you know about the dangers of debt?

Before watching the lesson, read each statement below and mark whether you agree or disagree in the "before" column. Then, after watching the lesson, do it again using the "after" column to see if you changed your mind on any question.

Before: Agree	Before: Disagree		After: Agree	After: Disagree
☐	☐	1. Co-signing a loan is a good way to help a friend or relative.	☐	☐
☐	☐	2. Cash advance and title pawning are needed services but should be used with caution.	☐	☐
☐	☐	3. The typical millionaire drives reliable, used cars.	☐	☐
☐	☐	4. Leasing a car is a smart way to drive a newer car for a lower monthly payment.	☐	☐
☐	☐	5. A new car is the largest purchase most consumers make that goes down in value.	☐	☐
☐	☐	6. A home equity loan is a substitute for an emergency fund and a good way to consolidate debt.	☐	☐
☐	☐	7. You need to have a credit card to rent a car or check in to a hotel.	☐	☐
☐	☐	8. It is OK to use a credit card if you pay it off every month.	☐	☐
☐	☐	9. Teens are the number one target of credit card companies today.	☐	☐
☐	☐	10. You spend more money when you pay with cash than when you use credit cards.	☐	☐

CH 4 DANGERS of DEBT

Debt Is Everywhere

According to *The Wall Street Journal*, ________% of Americans are living paycheck to paycheck.

When it comes to debt, if you tell a lie or spread a ___________ long enough, eventually it becomes accepted as the ________________.

Debt has been _________________ to us with such intensity for so long that to imagine living without it requires a complete _____________ shift, a completely new way of looking at things.

MORE INFO

When someone borrows money from another, we understand they have an obligation to repay. A study in the dictionary will show you what this really means. A definition of obligation is "bound," which is defined as "tied; in bonds: a bound prisoner."

"The rich rule over the poor, and the borrower is slave to the lender." (Proverbs 22:7) Don't become a prisoner or slave to debt!

History of Credit

- 1910: In the Sears catalog, credit was called "folly."

  J.C. Penney didn't believe in debt and would not allow credit to be given in his stores. It wasn't until after his death in 1971 that credit was widely accepted in the J.C. Penney stores.

  Henry Ford of Ford Motor Company hated debt and would not offer credit on cars for 10 years after General Motors began offering credit.

WISE GUYS

"Most people have the will to win, few have the will to prepare to win."

Bobby Knight

- 1950: This was the birth of what is now known as the credit card; Frank McNamara established partnerships with several New York City restaurants. His goal was to allow patrons the ability to pay for meals with a single payment card—the first credit card. McNamara's company, Diners Club, is still in business today.
- 1958: A West Coast bank, the Bank of America, issued a little piece of plastic called the BankAmericard to its customers. Later that year, American Express was born.
- 1970: Only 15% of Americans owned credit cards.
- 1976: BankAmericard changed its name to Visa.
- 1986: Sears got into a dispute with Visa over the fee structure. As a result, Sears created their own brand, the Discover Card. This quickly became the most profitable division of Sears.

Debt Through the Generations

Our **great grandparents** thought debt was a sin.

Our **grandparents** thought it was stupid.

Our **parents** borrowed on a few things.

We borrow on everything!

END OF VIDEO PART 1

Debunking the Myths

Myth 1

- MYTH: If I ________ money to a friend or relative, I will be helping them.
- TRUTH: The relationship will be strained or ________.

END OF VIDEO PART 2

Myth 2

- MYTH: By ________________ a loan, I am helping out a friend or relative.
- TRUTH: The bank requires a cosigner because the person isn't likely to ________. Be ready to pay the loan and have your credit damaged.

Myth 3

- MYTH: ________ ______________, rent-to-own, title pawning, and tote-the-note lots are needed __________ for lower income people to help them get ahead.
- TRUTH: These are horrible, greedy rip-offs that aren't needed and benefit no one but the owners of these companies.

80% of ___________ in America are first-generation rich. That means they started out with nothing, did smart stuff, and became millionaires. That's the opposite of what we're talking about here.

Q&A

"I'm going to college after I graduate and will need a credit card for various things, such as internet access. Can you recommend one that's better than the others?"

DAVE'S ANSWER:

I never recommend using credit cards. NEVER! You can obtain Internet access, make online purchases, and buy things in a store with a debit card.

Using a debit card, which is connected to your checking account, means you're spending money that's actually yours. You're not borrowing it from some bank and then paying interest on it. If you don't have money in your account, you won't be making purchases. That's the way it works and it's the smartest thing you can do.

Credit cards are the quickest way I know to become broke and stay broke for the rest of your life!

MONEY FACTS

New car dealers make the following profit:

$82 for the cash sale of a new car

$775 for financing a new car

$1,300 for leasing a new car

Smart Money Magazine

Myth 4

- MYTH: The ___________ and other forms of gambling will make me ___________.

- TRUTH: The lottery is a ________ on the poor and on people who can't do math.

Texas Tech University did a study on the Texas Lottery and found that people without a high school diploma spent an average of __________ a month playing the lottery. College graduates spent _________ a month on average.

When studies are done on the lottery, it's always the lower-income ZIP codes that generate the highest revenue or sales.

END OF VIDEO PART 3

Myth 5

- MYTH: ___________ payments are a way of life and you'll always have one.
- TRUTH: Staying away from car payments by driving reliable used cars is what the typical _____________________ does. That is how they became millionaires.

The average car payment today is $464 per month over 64 months.

Myth 6

- MYTH: __________________ your car is what sophisticated financial people do. You should always lease things that go down in value. There are tax advantages.
- TRUTH: *Consumer Reports*, *Smart Money* magazine and a good calculator will tell you that the car ________________ is the most ___________ way to finance and operate a vehicle.

MORE INFO

Secured loans and unsecured loans are the two types of loans typically available to borrowers.

An **unsecured loan** is given to borrowers based on their financial resources or ability to repay the loan. Nothing "secures" the loan. In other words, the lender does not have rights to a specific asset if the loan is not repaid. Personal loans, student loans, and personal lines of credit are examples of unsecured loans.

A **secured loan** is usually needed when borrowing large amounts of money. The loan is "secured" with collateral. In other words, if you default on the loan and your house was used as collateral, the lender would take the house. Secured loans usually have lower interest rates and longer repayment terms. Automobile loans, mortgages, and home equity loans are examples of secured loans.

Q&A

"My credit card has no annual fee and I get money back from the credit card company for all of my charges. I only use it for bills and I pay it off every month. So, I'm getting money from the credit card company for using their credit card. What's wrong with that?"

DAVE'S ANSWER:

I've been doing financial counseling for decades and I've worked with tens of thousands of people. During that time, I've repeatedly met folks who were doing exactly what you are doing and it has come back to bite them.

When you're talking about credit cards, you're talking about a multi-billion dollar industry designed to do just one thing—separate you from your money. And they're really good at it! They're more than willing to pay you a percentage point back because they know you're going to stumble at some point—and that's when they pounce!

I've talked with hundreds of millionaires, and I've never met one who said they got rich thanks to credit card rebates. They've all just gone about the business of earning money, living on less than they make, and saving. They don't play with snakes because they know, sooner or later, they'll get bitten.

WISE GUYS

"If you want to be well off financially, quit buying stuff!"

Anonymous

If you own a business, you can __________ _______ your paid-for car on taxes without paying payments for the privilege.

The way to __________________ the money lost on things that go down in value is to buy slightly _________________ .

END OF VIDEO PART 4

Myth 7

- MYTH: You can get a good deal on a _________ car.

- TRUTH: A new car loses ______ of its value in the first four years. This is the largest purchase most consumers make that goes down in value.

  On average, a $28,000 car will be worth $8,400 in four years.

Myth 8

- MYTH: I'll take out a 30-year mortgage and pay ____________________.

- TRUTH: Life happens and something else will always seem more important. Never take out more than a ___________ year fixed-rate mortgage.

30-Year vs. 15-Year Mortgage at 6%

$250,000 Home - $25,000 Down Payment = $225,000 Mortgage Amount

PAYMENT	TOTAL	PAY BACK
30 years	$1,349	$485,636
15 years	$1,899	$341,762
Difference	**$ 550**	**$143,874**

A 15-Year Mortgage Saved More Than $143,000!

FEEDBACK

Have you ever loaned someone money, only to have it turn into a bad experience?

"My friendship hasn't been the same since I loaned a friend money and didn't get it back. I don't trust him anymore."

Junior, Missouri

"A close friend of mine bought a new car and couldn't afford the payment. I loaned him $300, then he left the state. I couldn't afford to take him to court because of court costs, so I dropped the whole thing."

Junior, Michigan

"I loaned $150 to a friend who never returned it and then claimed that I 'gave' it to him."

Senior, Missouri

"I loaned my mother over $2,000 to help pay for my 19-year-old brother's car note and college fees. She promised to pay me back but it has been over a year and a half and I haven't received one payment from her. I will never loan money again."

Senior, Georgia

REAL LIFE

Sadly, it is easier than ever for 18-year-old college students to get credit cards. According to the Jump$tart Coalition for Personal Financial Literacy, students entering college are offered an average of eight credit card solicitations in their first week of school. In 2006, students received an average of 25-50 credit card offers per semester, according to the United College Marketing Services.

In 2001, CBS's *60 Minutes* correspondent Vicky Mabrey reported on the devastating effects credit card marketing had for one college student and his mother.

Sean Moyer was an 18-year-old National Merit Scholar with future law school plans when he headed off to the University of Texas in Dallas. Even though he had always worked from the time he was 16, Sean was naïve when it came to credit cards.

Like a lot of other freshmen, Sean applied for and received his first credit card when he got to college. Because of credit card debt, Sean was forced to transfer to the University of Oklahoma so he could live at home. By this time, he was working two jobs making minimum wage as a salesperson and gift wrapper for a major department store.

One day, his mother knocked on Sean's door but got no answer. Upon entering, she found him dead; he had hung himself in the closet. Sean Moyer was 22 at the time with $14,000 of credit card debt. His mother told *60 Minutes*, "It just never occurred to me that you could give a credit card to an 18-year-old making minimum wage. When he died, he had 12 credit cards." In 2007, CNN ran a similar story about credit card marketing on campuses and what happened to Sean Moyer. They reported that Sean's mother still receives credit card offers in the mail for her son, despite the fact that he died in 1998.

Myth 9

- MYTH: It's wise to take out an ________ or a ________________ mortgage if "I know I'll be moving."
- TRUTH: You *will* be moving when they ____________________.
- The adjustable-rate mortgage is here to keep the ________________ from losing money. It transfers the _________ of higher interest rates to you.

END OF VIDEO PART 5

Myth 10

- MYTH: You need a ____________ ________ to rent a car or make ________________ online or by phone.
- TRUTH: A ______________ card does all of that.

Myth 11

- MYTH: I pay my ____________ ________ off every month with no annual payment or fee. I get brownie points, air miles and a free hat.
- TRUTH: A recent Dun and Bradstreet study found that when you use cash instead of plastic, you spend ______________ less because spending cash hurts.

According to carddata.com, U.S. consumers racked up an estimated $51 billion worth of fast food on their personal credit and debit cards in 2006, compared to $33.2 billion one year ago.

Myth 12

- MYTH: I'll make sure my __________________ gets a credit card so he or she can learn to be responsible with money.
- TRUTH: Teens are a huge ______________________ of credit card companies today.

END OF VIDEO PART 6

$ MONEY FACTS

Before McDonald's chose to accept credit cards, the average ticket price was $4.75. When they went to credit cards, the average ticket price went to $7.00. That's a **47%** increase!

Nightline, ABC

Researchers studying the neurological impact of big purchases hooked up an MRI to participants and watched their brainwave activity. They found that when people **spend cash** it neurologically registers as **pain.**

Carnegie Mellon Magazine

Credit cards are moving away from a magnetic swipe and moving towards chips in the cards. It's called **RFID** technology and all you have to do when you use your credit card is wave it.

MONEY FACTS

88% of teens don't like the way it feels to owe someone money.

29% of teens are already in debt with the average amount owed at **$293.**

Only **41%** are concerned about paying back the money they owe.

29% of teens would prefer buying things with a credit card versus cash.

51% of teens agree that it is easier to buy things with a credit card than cash.

25% of teens say their parents/guardians are more likely to use a credit card than cash.

36% of teens believe that their parents/guardians are concerned about paying credit card bills.

Charles Schwab Survey

As soon as you get to college, you will receive offers from credit card companies. About 80% of college graduates have credit card debt before they even get a job.

Myth 13

- MYTH: The home equity loan is good for _______________ and is a substitute for the emergency fund.

- TRUTH: You don't go into ________ for emergencies.

Myth 14

- MYTH: Debt ____________________ saves interest and you get a smaller _______________.

- TRUTH: Debt consolidation is a ______________.

Debt consolidation saves little or no _________________ because you will throw your low interest loans into the deal.

You cannot _____________ your way out of debt!

_______________________ payments equal more ____________ in debt.

Myth 15

- MYTH: Debt is a ______________. It should be used to create prosperity.
- TRUTH: The ____________________________ is slave to the lender.

When surveyed, the Forbes 400 were asked, "What is the most important key to building wealth?" _____________ replied that becoming and staying ________________ free was the number one key to wealth building.

END OF VIDEO PART 7

Steps Out of Debt

1. Quit ___________________ more _________________!
2. You must __________________ money.
3. __________________ something.
4. Part-time ______ or ________________ (temporarily)
5. Use the ________________ __________________.

Baby Step 2

BABY STEP 2 Pay off all debt using the debt snowball.

END OF VIDEO PART 8

FEEDBACK

"I'm 23 years old and just getting started. I finished Baby Step 1 last week and am now onto tackling $2,700 in credit card debt. After that, it will be $17,000 in student loans. I, too, am grateful to be on this path now—and not 30 years from now."

Missouri

"I'm 23, $17,000 in debt, and miserable."

Michigan

"I make about $30,000 a year and owe $20,000 on my car. I was at $27,000 a year ago, so I'm getting there slowly but surely! I made a big mistake buying a new car and now I'm paying for it."

Texas

"I'm 22 and on Baby Step 2. I have about $2,200 left on a credit card and then $15,000 for my car and $20,000 in student loans. I currently work full-time plus overtime while running a small eBay business on the side."

Georgia

Debt Snowball

Now it's time to knock out that debt! List your debts in order, from the smallest balance to the largest. Don't be concerned with interest rates, unless two debts have a similar payoff balance. In that case, list the one with the higher interest rate first. As you start eliminating debts, you'll start to build some serious momentum. These quick wins will keep you motivated, so you'll be able to stay on track.

The idea of the snowball is simple: pay minimum payments on all of your debts except for the smallest one. Then, attack that one with gazelle intensity! Every extra dollar you can get your hands on should be thrown at that smallest debt until it is gone. Then, you attack the second one. Every time you pay a debt off, you add its old minimum payment to your next debt payment. So, as the snowball rolls over, it picks up more snow. Get it?

Redo this sheet every time you pay off a debt so that you can see how close you're getting to total debt freedom. The "New Payment" is the total of the previous debt's payment PLUS the current debt's minimum. As these payments compound, you'll start making huge payments as you work down the list.

ITEM	TOTAL PAYOFF	MINIMUM PAYMENT	NEW PAYMENT
JC Penney	$150	$15	(Garage Sale)
Sears	$250	$10	$25
Visa	$500	$75	$100
MasterCard	$1,500	$90	$190
Car	$4,000	$210	$400
Student Loan	$4,000	$65	$465

Recap and Review

Debt is heavily marketed to young people. You will receive a lot of offers from credit card companies.

The fastest-growing group of bankruptcy filers consist of people under 25 years old.

Car payments do not have to be a way of life.

You do not need to build your credit score by applying for a credit card.

The best way to beat debt is to quit borrowing money and live on less than you make.