Teen Guide to Credit and Debt

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Teen GUIDE TO Finance$

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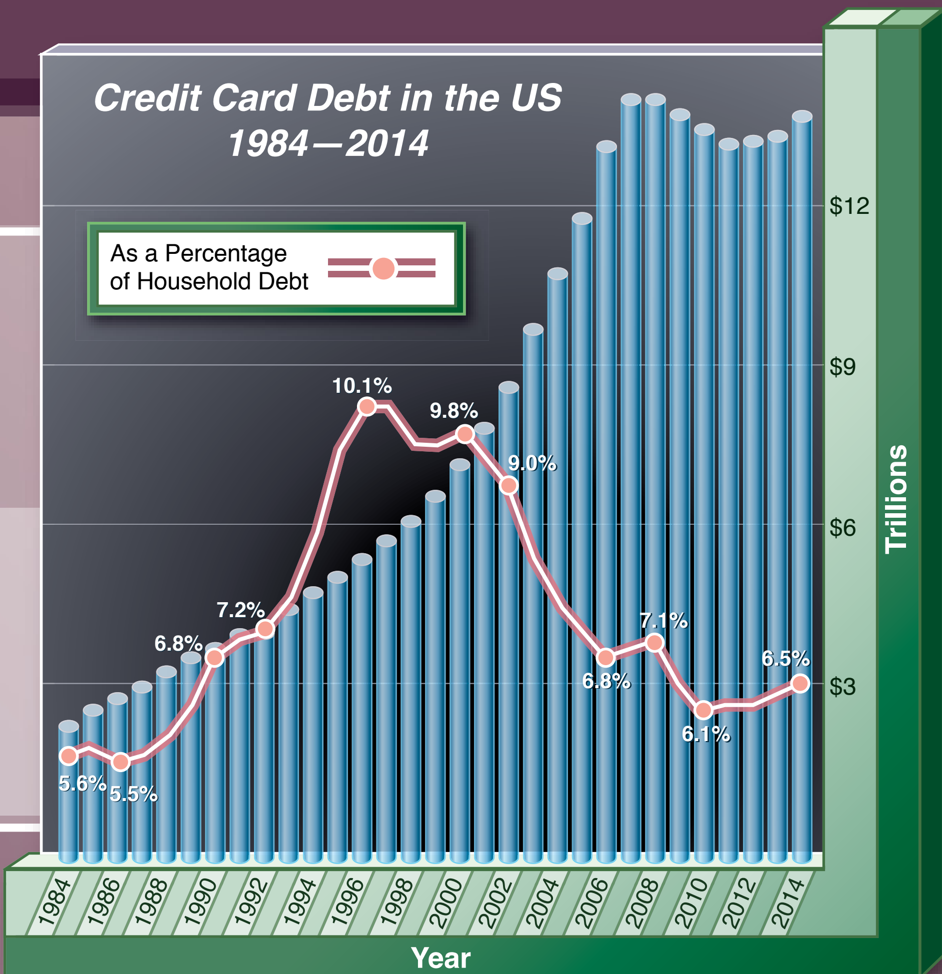
Credit Card Debt Has Fallen to a New Low

Credit card debt, as a percentage of total US household debt, has steadily dropped since 1997 and, in 2014, it reached the lowest level since 1990. This finding appears in the 2015 Nilson Report, a trade newsletter covering the card and mobile payment industries. In the graph, the blue bars represent growth in total household debt, an amount that equaled $13.5 trillion at the end of 2014. Credit cards accounted for only 6.5 percent of that debt at the end of 2014 compared with about 10 percent in 1996, when credit card debt reached its highest level since 1984.



Source: *Business Wire*, "The Nilson Report: US Household and Credit Card Debt 2014," June 24, 2015. www.nilsonreport.com.

Chapter One

Credit

An online ad hypes a new version of Apple's iPad. A television commercial advertises a new, extreme role-playing game. Magazine ads showcase the latest designer jeans and splashy jewelry. In the world of commerce, these types of advertisements are often aimed at the approximately 40 million teenagers in America, whose purchases range from shoes and music downloads to fast food and concert tickets. Results of polls taken by several marketing companies and *Seventeen* magazine revealed that spending by and for US teens totaled $258.7 billion in 2014.

At the same time, however, many of the consumer goods that appeal most to teens are more expensive than they can afford. A teenager considering such a purchase has several choices. One is to simply do without the latest gadget or fashion accessory. Another choice is to save up enough money until he or she can afford to make the purchase. A third option is to spread out the cost of the item in affordable installments: in other words, to buy on credit.

Credit—the concept of purchasing goods or services with the expectation of future payment—is not new. As early as 1300 BCE traders in ancient Babylonia were making business transactions employing a type of credit. Today millions of people use credit to purchase things that are necessary for daily living or that add enjoyment to life. Houses, furniture, cars, and family vacations are some of the many costly items that are likely to be purchased on credit. Without such financial arrangements, businesses would be forced to rely on cash-only transactions, and expensive items would only be affordable to the very rich. With credit, people can buy the goods they need or desire that would otherwise go unsold. In short, credit is an important basis of today's economy; without it, the economy would likely collapse.

Sources of Credit

For many people in search of credit, the first place they look is where the money is located: a bank. Most banks offer credit in the form of loans to purchase automobiles, houses, home repairs, and other big-ticket items that are usually paid for over time. Loans usually include a monthly fee, called interest, which pays the bank for lending the customer the money. For many teenagers, buying a car is often the first major purchase made on credit, a transaction usually referred to as financing the automobile. A bank will examine a potential buyer's financial situation before offering a loan. A good place to begin looking for a loan is a bank where the teen has a savings or checking account.

A savings and loan (S&L) company is similar to a bank and offers many of the same types of loans and other financial services. S&Ls deal mainly with home loans but often provide other consumer financing, such as auto

Is There Life Without Credit?

The signs of our credit-obsessed society are everywhere, from the boasting of a "low, low, low!" interest rate on television car commercials to the numerous credit card offers that fill American mailboxes with alarming regularity. With all the seemingly easy-to-obtain credit out there, is it possible to live without credit and debt?

Travis came from a credit- and debt-free family. His parents watched every penny, buying generic groceries, patching clothes, and limiting eating out to special occasions celebrated at the local McDonald's. The only debt they had was a mortgage, and they always made more than the minimum payment to shorten the life of the loan. Theirs was a lifestyle without credit cards, and the payoff for Travis was graduating from college debt-free.

Each family is different, and not everyone can live a life without debt. Also, there may be consequences of living without ever using credit, such as not building up a good credit history, which may be necessary when applying for certain jobs. But for those who have the determination to stick with it, striving for a debt-free life is a worthwhile goal.

loans. Banks offer these types of loans as well but also service corporate and government customers.

A credit union is another source for financing purchases. Unlike banks or S&Ls, credit unions are nonprofit cooperatives that are owned by the people who deposit their money with them. Their customers are members, and as a group they determine the policies of the credit union. Usually smaller than banks, credit unions offer their members car, home, and other consumer loans and can provide more personal service to their customers.

Young car buyers discuss details of a loan offered by a car dealership. A car is often the first major purchase for a teenager—and the financial responsibility of owning a car can be an eye-opening experience.

diploma. But those extra earnings can come with a hefty price tag. According to the College Board, a non-profit organization that administers standardized tests and provides information about college admissions, in 2015 the average tuition for a four-year public college was about $9,400 per year; for private colleges, annual tuition averaged more than $32,000.

Scholarships and grants can help with the cost of college, but not all students will qualify for them. For these students, loans can make an education possible. Studies have shown that about 70 percent of college students have taken out loans for their education. Kevin, a college graduate in Alexandria, Virginia, decided that his college education was worth taking out loans. On the website Student Debt Crisis, Kevin says, "I borrowed the majority of my college costs believing that I was investing in my future. No one made me borrow the money. No one coerced me into going to college. A college degree was something that I decided, on my own, was important to me."

Buying a car is often a teenager's first major purchase. Automobile loans can finance the purchase of a new or used car, and can be the first opportunity to build a good credit history. An auto loan usually requires a down payment, with monthly payments on the balance lasting from four to seven years. The expense of owning a car may be an eye-opening experience for a teen. State laws usually require a minimum level of liability insurance on a car, which will be an extra expense in addition to the loan payment. Gas, maintenance, and unexpected repairs also add to the cost.

A home is the largest and most important purchase that most people will make in their lifetime. But very few have enough money to buy a house or condominium outright. A mortgage is a loan taken out to allow the purchase of a home with a small down payment and then financing, or mortgaging, the balance with interest over a number of years. Home mortgages can last anywhere from ten to thirty years or more. Once a home is purchased, some people also obtain loans from department or furniture stores to furnish the new residence.

"I borrowed the majority of my college costs believing that I was investing in my future. No one made me borrow the money. No one coerced me into going to college. A college degree was something that I decided, on my own, was important to me."

—Kevin, a college student

Loans can either be secured or unsecured. In a secured loan, the amount borrowed is backed up by something of value that the borrower owns; this is called

Glossary

annual percentage rate (APR): The amount of interest a lender charges for a loan over a period of one year, expressed as a percentage.

bankruptcy: A legal proceeding allowing individuals and businesses to declare they cannot repay their debts, often with a court-ordered plan to make partial repayment.

budget: A plan created by an individual, family, or company to manage income and expenses, create financial goals, and make plans to achieve those goals.

collateral: Something of value that is held until a debt is paid. If the debt is not repaid, the collateral can be sold to recover the amount of the loan.

credit: The economic system of allowing customers to make purchases now and pay for them at a future date, usually with interest.

credit history: The record of buying and borrowing habits, used by lenders to evaluate a person's expected ability to repay a loan or credit card charge.

credit limit: The maximum amount that can be charged on a credit card. Going over the credit limit will generate a fee.

debt: An amount of money owed to a person, business, or financial institution.

For More Information

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