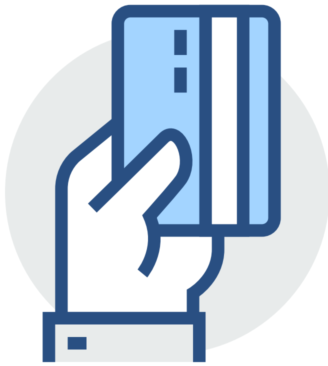


UNIT 6
Using Credit Wisely

Topic

Improving Your Credit Score

LEARNING OBJECTIVE(S)

Students will:

- **explain** the factors lenders consider before making a loan.
- **evaluate** the characteristics of potential borrowers and the impact on their likelihood of getting a loan.

Title

Who Gets the Loan?

Overview

How are credit scores used, and why is having a good one important?
After discussing what they already know about the loan application process, students consider their personal prospects for obtaining credit. Student "loan officers" evaluate the profiles of five individuals seeking car loans and make recommendations about which should receive loans.

Financial Literacy Theme

Using Credit Wisely

21st Century Skill(s)

Critical Thinking, Collaboration, Communication

Key Terms

Credit report, credit score, loan, interest rate, co-signer,down payment, trade-in

Materials

- **Can I Get a Loan? Student Handout**—one copy per student

Connect

How does this connect to the student?

Students may someday need a loan to make a large purchase such as a vehicle, higher education, or a home. Their ability to qualify for the loan will depend, in part, on their credit history. In addition, individuals who qualify for the best interest rates can save thousands of dollars over the course of a loan on interest payments.

How does this connect to careers?

Loan Officer: The Bureau of Labor Statistics predicts that the number of loan officer jobs will grow at a better than average rate through 2026. Individuals in this role typically have a bachelor's degree. They receive on-the-job training to prepare them for their role of evaluating loans for individuals and businesses. Those who authorize home loans (mortgages) must also be licensed.

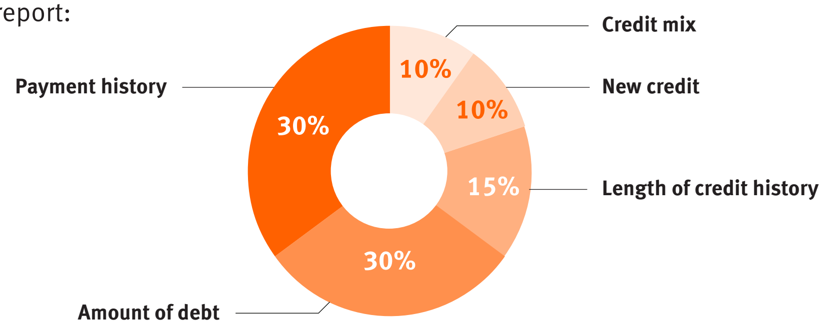
How does this connect to the world?

The method used to calculate credit scores used to be a tightly held secret. Now people can pay to get their credit scores or sign up with an online service that estimates credit scores. People who are concerned about identity theft can also use technology to closely monitor their reports and be alerted to any suspicious changes.

Prepare

Background: It is a common misconception that credit scores are used only in making loan decisions. In fact, credit scores are utilized for many other purposes: potential employers use credit scores when deciding whether or not to offer someone a job, landlords use them when screening potential renters, and insurance companies use them when deciding how much to charge for a policy. Credit scores typically range from 300 to 850. A person with a score of 670 or higher is usually considered as having "good credit." Scores are determined by private companies such as FICO and Vantage, using data from credit reporting agencies, namely Experian, Equifax, and TransUnion. You can actually have different scores depending on which credit bureau provides the information and the purpose for requesting the score. Credit scores are calculated based on the following information found in a person's credit report:

- Payment history: 35%
- Amount of debt: 30%
- Length of credit history: 15%
- New credit: 10%
- Credit mix: 10%[2]



Engage

- Ask students what they know about applying for a **loan** (a sum of money that is borrowed and usually repaid with interest). What information is required? Why do people apply for loans?
- Explain that lenders use information about a person's financial situation (such as their income, job history, and savings) to make loan decisions. Another important factor is the borrower's **credit score** which lets the lender know what type of borrower the person is. Do they pay loans back on time? How much do they owe other lenders? How long have they used credit?

[2] http://www.fico.com/en/node/8140?file=11489

- While students shouldn't have a credit score until they are 18-years-old and able to legally enter into contracts, they can think about their own personal borrowing habits. Challenge students to think about times they have borrowed money or an item (from a friend, relative, library, etc.). How would they grade themselves as borrowers? Do they return items in the same condition they were in when they borrowed it? Do they return things on time? Do they need reminders? All of these are considered as borrowing habits and lay the foundation for establishing good credit as an adult.

Teach

- Let students know that they will be playing the role of a lender making a decision about whether or not to give a car loan to an imaginary person.
- Divide students into small groups. Distribute a copy of the **Can I Get a Loan? Student Handout** to each student. Review any unfamiliar terms such as ***co-signer*** (a relative or friend who is willing to accept responsibility for a loan if the original borrower does not repay it), ***down payment*** (an initial payment when something is bought with credit), and ***trade-in*** (selling a used car to the dealer in order to reduce the amount owed for a newer one).
- Direct students to review the profiles of each person applying for a car loan. They should assume the role of the loan officer for a bank that provides financing for the car dealer. Their job is to decide which people to offer loans and to make a recommendation to the bank manager—you. Remind students that more goes into the loan approval process than just a credit score. They should also consider the person's ability to repay the loan (tied to their income or job). For this exercise, groups may give loans to **up to three** people and must be able to defend their choices. In addition, they can offer **one** borrower their best (lowest) ***interest rate*** (the amount charged to the borrower—usually expressed as a percentage). This should go to the person they believe will be the best borrower. Again, they should be prepared to defend their rationale to you and the rest of the class.
- Allow groups time to discuss each profile and reach a decision. Let them know when they will be asked to complete their conversations and submit their decisions. For your reference, the table below summarizes the information in the profile descriptions. Amounts noted with an asterisk (*) must be calculated by the students.

	Alicia	**Xavier**	**Olivia**	**Liam**	**Quentin**
Age	43	22	32	24	47
Job	New job—unknown	None—recent college graduate	Graphic designer	Auto mechanic	Chiropractor
Credit Score	570 Poor (divorce)	682 Fair	810 Excellent	678 Fair	750–780 Very good
Price of Vehicle (after trade-in, if any)	$15,670	$32,450	$18,490	$20,760	$63,270
Down Payment	$9,670*	$8,000	$5,000	$5,500	$22,000
Loan Amount Requested	$6,000	$24,450*	$13,490*	$15,260*	$41,270*

- While students discuss their options, list the names of the five people applying for loans on the board: Alicia, Xavier, Olivia, Liam, and Quentin.
- Direct students to write down the names of the three people they would give loans to and circle the one that will get the best interest rate. Collect the names and put a tally mark next to each person's name on the board each time a group decides to give them a loan. For example, if three groups said they would loan money to Xavier, put three tally marks next to his name. Use stars to represent votes for the best interest rate.
- Ask groups to defend their decisions. Consider these follow-up questions: Why did they decide to lend money to some and not others? How did they choose who would qualify for the best rate? Did they take into consideration certain pieces of information more than others? Did the person's age or job factor into their decision? How important was their credit score in the decision making process? What advice would they give to the people they turned down? If they had been allowed to give loans to more than three, would they have done so and, if so, to whom? Student responses will vary along with their rationales; however, most will offer credit to both Olivia and Quentin with one of the two receiving the best interest rate. Similarly, the choice of the third person is usually between Liam, Xavier, and Alicia (often in that order). Students should be challenged to explain their rationales. Below are questions to guide consideration of each person:
    - **Alicia:** Would you look past Alicia's poor credit since she claims it is due to her ex-husband? Alicia has a new job. Do you feel comfortable with her ability to repay the loan if she hasn't been working there long? Does the fact that Alicia has saved over half the money for the car influence your decision?
    - **Xavier:** How much of a risk is it to lend money to someone without a job? Does the fact that Xavier's parents will co-sign the loan make a difference—especially when you don't know anything about their credit? Are you impressed with his ability to save $8,000 by age 22, or does that not factor into your decision?
    - **Olivia:** Olivia has the highest credit score in the group. How big of a role does Olivia's excellent credit play in your decision-making process? Do you have any concerns about her ability to repay a loan?
    - **Liam:** How concerned are you about Liam's fair credit score? Should the rumors about his job location closing influence his ability to get a loan?
    - **Quentin:** What factors most influenced you when considering Quentin's application? Are you concerned about his ability to repay? Should he or Olivia be offered the best interest rate? Why?
- Share with students that lenders are not the only ones who use information such as this to make decisions. Credit scores, in particular, are also used by potential employers, landlords, and even insurance companies. Ask students why credit scores might be used in making decisions that go beyond lending.
- Remind students that credit scores are calculated based on information in their ***credit reports*** (detailed reports of a person's credit history). They can improve their chances of having a good credit score by always paying bills on time, using credit responsibly, and beginning to establish a credit history early.
- Encourage students to reconsider their current behaviors and how they might influence their future credit habits. For example, do they turn assignments in on time and without reminders? If not, how can they improve that behavior so that when they are responsible for paying bills they can keep track and pay them on time?

Extend

- **Action:** Students should not have a credit report or credit score until they begin entering into credit agreements or other contracts; however, children are frequent victims of identity theft. The Federal Trade Commission recommends that all young people check to make sure they do not have a credit report at age 16—in advance of applying for loans or seeking a job or apartment. To do so, parents will need to contact each of the three major credit reporting agencies for their child. See the FTC website at https://www.consumer.ftc.gov/articles/0040-child-identity-theft for more information.

- **Family:** Encourage students to discuss credit with family members. When would be a good age for them to start establishing credit? If parents have good credit, making their child an authorized user on a credit card may help their child to begin to establish a credit history if the card issuer reports authorized users to a credit bureau.

Standards Correlation

National Standards for Financial Literacy from the Council for Economic Education

4. Lenders make credit decisions based in part on consumer payment history. Credit bureaus record borrowers' credit and payment histories and provide that information to lenders in credit reports.

4. Lenders can pay to receive a borrower's credit score from a credit bureau. A credit score is a number based on information in a credit report and assesses a person's credit risk.

4. In addition to assessing a person's credit risk, credit reports and scores may be requested and used by employers in hiring decisions, landlords in deciding whether to rent apartments, and insurance companies in charging premiums.

4. Lenders charge different interest rates based on the risk of nonpayment by borrowers. The higher the risk of nonpayment, the higher the interest rate charged. The lower the risk of nonpayment, the lower the interest rate charged.

Can I Get a Loan?

Directions: Imagine you are a loan officer for a bank. The five people below have each applied for a car loan, but you can only offer a loan to three of them. Consider all of the information below. Then, select the three people to offer a loan and decide which of them will be offered the best/lowest interest rate. Be prepared to explain your decisions to the class.

Alicia
Alicia is a 43-year-old woman. She is recently divorced and has a poor credit score of 570. When she applied, she explained that her poor credit is mostly due to her ex-husband not paying bills on time. She is hoping to purchase a certified used vehicle. She needs something she can rely on for her new job. She has been saving for this for a long time. Of the $15,670 purchase price, she only needs a loan for $6,000.

Xavier
Xavier is a 22-year-old recent college graduate. He's living at home with his parents until he can get a job. He feels his last interview went well and is hopeful he will get a job offer in the next two weeks. He started building credit a year ago by using a credit card and paying off the balance every month. His credit score is fair at 682. Xavier's concern for the environment made him want an electric car. He knows it might cost more to purchase, but hopes it will cost less to own and maintain since he won't be buying gas. The one he wants will cost him $32,450. He has saved $8,000 and needs to finance the rest. His parents have agreed to be co-signers on the loan.

Olivia
Olivia is a 32-year-old graphic designer expecting her first child. She wants a bigger car that will easily fit her husband, new baby, dog, and a stroller. The four-door sedan she's picked will cost her $18,490 after using her current vehicle as a trade-in. She has saved $5,000. Olivia has an excellent credit score of 810 which she achieved by paying her bills on time and establishing credit early. Other than a small amount left on her student loans, she has no other debt at this time.

Liam
Liam is a 24-year-old auto mechanic. He has been working full-time for two years, but he has heard rumors that the company may be closing his facility. He wants to buy a reliable, pre-owned truck with low mileage. He's been looking for a while and found one that will meet his needs and his budget for $26,560. He will use his old pickup as a trade-in bringing the cost down to $20,760 and then pay a down payment of $5,500 from his savings. Liam's credit score is fair at 678.

Quentin
Quentin is a 47-year-old chiropractor. Since their kids are getting older, he and his wife have decided to replace their minivan with a luxury SUV. The one they have picked will cost them $63,270. They have decided not to trade in their minivan, but they will make a down payment of $22,000. Quentin has a very good credit score at 780.