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New

credit

Borrowing Money

The Texas A&M
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Borrowing Money

Borrowing money is called many things in the world of credit. It may be called “cash credit,” “cash loans” or just a “loan.” Whatever it is called, it means one thing: the borrower receives money, not merchandise.

Loans are available in amounts as little as \$10 or more than \$10,000. You can borrow money for only a few days or for several years.

Borrowing money can work in two ways. One way is to borrow the money for a certain period — 6 months or 1 year — and at the end of that time you must repay all of what you owe. The second way is to borrow the money today and repay the loan in regular installments until the amount you borrowed and the finance charge are paid in full.

Where To Go For a Loan

If you want to buy a new refrigerator, you don't just walk into the first store you pass and buy one. You look around, decide which brand or model you want and then shop to find the dealer who gives you the best price for what you want.

When you need a loan, it should be the same, except you want to buy **money**. But you still need to decide how much you need and what it is for, then shop around to find the cheapest loan.

Here are the places you might go:

- A credit union
- A local bank
- Your life insurance company
- A finance company
- A savings and loan association
- A pawnshop
- An illegal lender or loan shark

Credit Union

Credit unions are organized by groups of people with something in common, such as working in the same business. Loans are given only to members. To become a member, you must buy at least one share of stock which usually costs under \$10. Operating costs are low because some members work without pay for the credit union. Office space may be free. Because of the low operating costs, rates of interest for borrowers are usually low. Loan repayments often may be taken directly off the borrower's wages each month. It may take a few days to find out if you can get the loan.

Local Banks

Commercial banks will make loans to people for such reasons as making home improvements or buying a car. Banks within a community may lend different amounts of money and charge different rates to different customers. This is usually a good source of credit for the family that has a good credit rating and something of value as security. The security could be a car or a life insurance policy.

Life Insurance Policy

Life insurance companies lend money to policyholders if they have had a cash value life insurance policy long enough. Policies usually tell the amount of money that the company will lend on the policy. During the time of the loan, the value of the insurance policy is lowered by the amount borrowed. The interest charged on this type of loan is usually the lowest of any lender because you are really borrowing your own money. But not everyone has this kind of life insurance to borrow on.

If the policyholder dies while still owing money on the loan, the loan is repaid from the insurance money before any insurance benefits are paid. Insurance companies may not have deadlines for paying back the loan. This may encourage the borrower to put off repayment.

Finance Companies

Consumer finance companies in Texas make loans from \$1,000 to \$10,000 or more in some companies.

The interest rate charged depends on the size of the loan, but is usually higher than from banks or

credit unions. Some consumer finance companies deal only in small loans (\$100-300). Others make only larger loans. It may take a day and a half to get the loan.

Savings and Loan

If you have a savings account at a savings and loan association, you may be able to get a low-cost loan by using your savings account as security (collateral). Check with your local savings and loan to find out other kinds of loans available.

Pawnshops

When you borrow money from a pawnshop, you must leave something valuable, such as a watch or a TV, with the pawnbroker. A pawnshop rarely gives you more than 50 percent of the value of your property.

High interest rates are charged on the loan. If the loan is not repaid by the time you agreed to pay it, the pawnbroker can sell what the borrower left as security. To pawn items may be one of the most expensive ways to borrow money.

Loan Sharks

People who are in desperate need may consider borrowing money from illegal lenders or "loan sharks." Their finance charges are higher than those of any other source of credit, and the borrower who misses a payment may be in serious trouble. For your own protection, avoid borrowing money from a loan shark. They are illegal and may use threats or violence to make you pay.

Secured or Unsecured Loans

All loans are either secured or unsecured. The difference between the two is explained below:

Secured loan — A secured loan requires two things from the borrower:

1. The borrower's written promise to repay.
2. The pledge of security that may be either **collateral** or a **cosigner**.

Collateral is something you own, such as a car, household furniture, expensive jewelry or other personal property. Or it may be the item you are buying with the loan. Security could also be a **cosigner** who signs the loan agreement and promises to repay the loan if the borrower does not. The lender can repossess the collateral (property) or force the cosigner to pay the loan.

A lender will demand security for a very large loan or if the borrower's credit history is weak. However, the borrower's ability and willingness to repay are still the main factors a lender uses to decide whether a loan should be granted.

Unsecured loan — The borrower's promise to repay is the lender's only "security" behind an unsecured loan. No collateral or cosigner is required. Unsecured loans are typical if the amount of the loan is small or the borrower's credit record is top-grade and well-established.

When shopping for a loan, compare several lenders. Look for:

- **Monthly payments you can afford**
- **A low Annual Percentage Rate (APR)**
- **An honest lender**
- **A contract you can understand**

Other publications in this series include:

- L-1881 Understanding Credit Costs
- L-1882 Deciding When to Use Credit
- L-1883 When You Apply for Credit
- L-1884 What is Credit?
- L-1885 Using Credit Cards
- L-1887 Handling Credit Problems
- L-1888 Buying on the Installment Plan

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