Economics

Credit Scenario Activity

**Scenario 1: Tiffany had been at college for one week and she loved every minute of it...the classes, the new people, the parties...everything was new and exciting to her. Walking through campus one day, there were tons of people gathered in front of the Student Union. A guy carrying a clipboard walked up and asked Tiffany if she’d be interested in earning free movie tickets and a shirt by filling out an application for a credit card. Tiffany had never had a credit card, and the thought of being able to purchase some new shoes and outfits before rushing the sorority she wanted to join was very appealing to her. She explained that she didn’t have a job, but the guy said that didn’t matter. All she’d need to do is come up with her monthly minimum payment, which was generally only around $10-$15 for most people. It sounded like a dream come true to Tiffany. She was sure she could afford such a small amount of money each month, so without asking any more questions or even reading the form, she signed up. She walked away with her t-shirt, went to the movies for free that very night with some friends, and received her first credit card in the mail around 3 weeks later. Tiffany was shocked when she realized the limit on her credit card was $3,000! Her mind soared over all the things she could get with that much money. With only 5 days before rush, she headed to the mall for a shopping spree. Tiffany couldn’t believe her luck.**

1. Let’s assume that Tiffany spent $375 on new clothing and shoes. How many months will it take her to pay off $375 if she makes the minimum payment of $15 each month?

**When Tiffany signed up for her credit card, or when she received it in the mail, did she ever check to see what the APR was on the card? Let’s assume the APR was 21%.**

2. According to the chart, how many months did it take Tiffany to pay off her purchase?

3. How much did Tiffany end up spending in interest alone? (In other words, how much did she pay as a penalty for buying on credit?)

4. How much did her $375 in clothing end up costing her in total?

5. Do you think Tiffany realized this is what her new clothes and shoes would cost her? What advice would you give Tiffany at any point in her scenario?

6. Most people who have credit card balances that they don’t pay off each month tend to open additional cards. What consequences could Tiffany face if she opens additional credit cards?

**Scenario 2: José wants to buy a stereo for $650 and pay for it using a credit card that has an Annual Percentage Rate of 19.85%.**

**If José pays the minimum monthly payment of $21.45:**

1. How long will it take him to pay for the stereo?
2. What is the total amount José will pay for the stereo?
3. What is José’s total cost of using credit?

**If José makes monthly payments of $60:**

10. How many months will it take for José to pay off the stereo?

11. What is the total amount José will pay for the stereo?

12. What is José’s total cost of using credit?

**Scenario 3: Marie just used her new credit card to buy a bike for $400. Her budget allows her to pay no more than $25 each month on her credit card. Marie has decided not to use the credit card again until the bike is paid off. The credit card she used has an Annual Percentage Rate of 21%.**

**If Marie pays $25 each month on her credit card:**

13. How long will it take Marie to pay for the bike?

14. What is the total amount Marie will end up paying for the bike?

15. How much interest will Marie pay for using her credit card to buy the bike?

**If Marie pays the minimum payment of $14 each month:**

16. How long will it take Marie to pay for the bike?

17. What is the total amount Marie will end up paying for the bike?

18. How much interest will Marie pay for using her credit card to buy the bike?

**Scenario 4: Patty took a cash advance of $1,500. Her new credit card charges an Annual Percentage Rate of 21%. The transaction fee for cash advances is 3% of the cash advance, with a maximum fee of $35. This fee is added to the total cash advance, and accrues interest.** (Based on a total advance of $1,535 ($1,500 + $35 transaction fee))

**If Patty makes monthly payments of $65:**

19. How long will it take Patty to pay for the cash advance?

20. What is the total amount Patty will end up paying for the cash advance?

21. What is the total finance charge Patty will pay?

**If Patty pays the cash advance back at a rate of $130 per month:**

22. How long will it take Patty to pay for the cash advance?

23. What is the total amount Patty will end up paying for the cash advance?

24. What is the total finance charge Patty will pay?

\*Based on a total advance of $1,535 ($1,500 + $35 transaction fee).

**Debt to Income Ratio:**

25. Nancy and Thomas have a combined monthly net income of $1,200. What is the most they can afford to pay for installment and credit card debt?

26. Jessie has a monthly net income of $800. His fixed monthly expenses consist of $150 for rent. He currently pays $80 each month for a credit card bill, and now he wants to buy a car. What does Jessie have left in his budget for a car payment to stay within his safe debt load?

27. Carla has a monthly net income of $450. She wants to buy new clothes and pay for them using a credit card. What is the largest monthly payment she can commit to making?

28. Jorge has a monthly net income of $640. His fixed monthly expense consists of a rent payment of $120. Right now, how much can he afford to borrow to stay within his safe debt load?

29. Jorge also has a car payment of $125 per month. Jorge wants to buy new tires for his car. The tires will cost him $40 each month on his credit card. With his car payment and the new tires, will he still be within his safe debt load?

30. What percentage of his net income, after rent, will he now have committed to debt payments?