THE REAL COST OF CREDIT

Every form of credit is a loan. When you borrow money, make sure you understand the terms (how much it will end up costing you in interest, fees, and penalties) and time (how long it will take to pay off the loan in full). Here's how to figure this out.

Suppose you see this sign in a store window.

RENT TO OWN A **NEW** WASHING MACHINE

For only **$22.00** a week, you can have a new washing machine!

NO MONEY DOWN!

EASY PAYMENTS

Own it in 24 months!!
If purchased in cash, $650

You don't have the cash to buy this right now. And you're absolutely sure you need the washer. Before you sign up, do the math to figure out how much the terms of this loan will cost over time.

A. FIGURE IT OUT

1. Find the length of the loan in weeks. _____

2. Multiply the total number of weeks by the weekly payment to find out how much you will owe. _____

3. Subtract the cash price from the total amount you will owe if you go with rent-to-own. The difference is the amount of interest you will be paying—in other words, the cost of this loan. _____
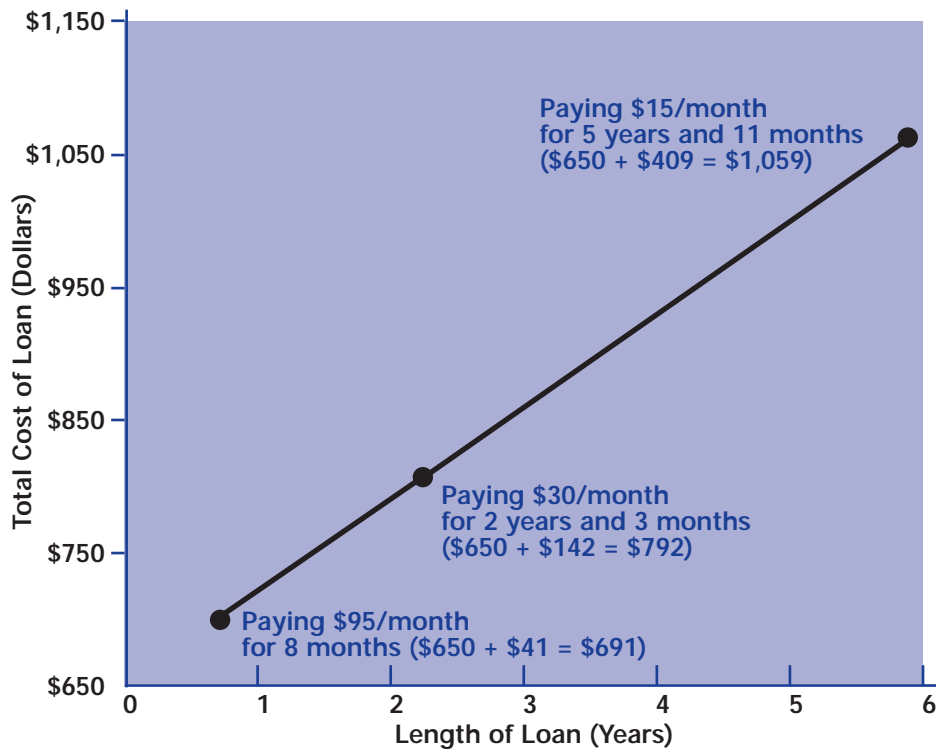
Did You Know?

The Web has easy-to-use loan calculators. Plug in the principal and figure out the cost of any loan at different interest rates and over different periods of time. Search for "debt reduction planner," "loan calculator" or "credit-card calculator" and find one that's easy to use.

B. WHAT IF YOU CHARGE IT?

Suppose you charge the $650 washer to your credit card. And suppose your card has an APR (annual percentage rate) of 17.99%, with interest compounded monthly.

Look at the chart below to see how long it would take you to pay off the washer—and how much extra money that washer will cost—if you paid only the minimum of $15 a month at 17.99% APR. What if you paid double the minimum, $30 a month, at the same APR? What if you paid $95 a month?

Total Cost of Loan (Dollars)

Paying $15/month for 5 years and 11 months ($650 + $409 = $1,059)

Paying $30/month for 2 years and 3 months ($650 + $142 = $792)

Paying $95/month for 8 months ($650 + $41 = $691)

Length of Loan (Years)

(Chart: Total Cost of Loan vs. Length of Loan, with y-axis from $650 to $1,150 and x-axis from 0 to 6 years)

Remember: if you charge anything else to your card during this time, you'll pay MORE interest. Penalties or late fees will also increase your debt.

C. WHAT ELSE CAN YOU DO?

What if you put $22 a week into your savings? How long would it take to save $650 for the washer?

Do the math here: _____

Pay more than the minimum!

On average, people who pay only the minimum due each month will take 45 years to pay off their credit cards, paying many times more than the amount they borrowed.

A. 1) 24 months = 2 years, 1 year = 52 weeks. 52 + 52 =104 weeks. 2) $22 x 104 = $2288. 3) $2288 - $650 = $1638. That adds up to about 168% interest. C. Divide $650 by $22. It would take about 30 weeks (7 months) to save for the washer.