



BE CREDIT SMART



This is the third of a 12-part series aimed at educating consumers to be more financially responsible for themselves and their families. This series is produced by the Consumers Association of Singapore (CASE) and The Association of Banks in Singapore (ABS) as part of the MoneySENSE National Financial Education Programme. This series is supported by the following financial institutions: American Express Foundation, ABN AMRO, Citibank, DBS Bank, HSBC, Maybank, OCBC Bank, Standard Chartered Bank, and United Overseas Bank. Today, we look at credit and borrowing.

that it is within your credit limit before issuing a cashier's order or cheque.

- A credit or charge card is a convenient way to make purchases. When you pay, you sign the sales slip and receive a receipt. The card issuer bills you each month. At the due date of the bill (*in the case of a credit card*), you may make full or partial payment of the outstanding amount owed,

subject to a minimum amount. Interest will be levied on the portion of the outstanding amount that is not paid after the due date. Charge card members are expected to pay the entire amount stated in their monthly bill.

- A pawnshop accepts personal property, such as jewellery and electronics, as collateral for loans, usually at less than the resale value of the goods.

If you cannot repay the loan, the pawnshop can keep or resell your personal property.

Credit charges

Interest payment is not the only cost of borrowing money. Other charges may apply, such as:

- **Amendment fee:** For changes to the original loan application;
- **Cancellation fee:** For not taking up the loan after accepting it;

- **Late fee:** For not repaying promptly;
- **Prepayment fee:** For paying back part or the whole loan early;
- **Processing fee:** For processing the loan application (*only when loan is approved*).
- **Default charges:** For not making repayment; and
- **Excess charges:** For drawing over the original overdraft limit.

When you borrow money, you have to pay back what you owe sooner or later, usually with costs, such as interest. So, is there ever a good reason to borrow money?

unsecured loans, the lender does not have direct access to your assets. Interest rates for such loans tend to be higher.

Categories

Credit comes in many forms, with different terms. They include the following:

- A housing or mortgage loan is a secured term loan. Repayment is usually over many years because the sum is likely to be big and is made in monthly instalments, comprising principal (*the sum you borrowed*) repayment plus interest.
- A motor vehicle loan can be a term loan or hire purchase (HP). In HP, the lender is the owner of the HP agreement and you are the hirer. If you cannot make the monthly repayment, the lender can repossess your vehicle. You still have to make up any shortfall.

Few of us can fork out cash for a large transaction, such as buying a property. However, whether buying property is worth taking a loan for depends on your outlook and your lifestyle.

Should you decide to take a loan, one of the most important things to consider is your ability to repay the loan. For instance, your monthly repayment should not impose an undue financial strain on you and your family. Otherwise, consider taking a smaller loan or look for other ways, such as increasing your income or deferring your purchase.

Types of credit

Financial institutions usually offer either term or revolving loans. Term loans mean that the money owed must be fully repaid over the loan period. Revolving credit, on the other hand, allows you to use the money when you need it and to tap into the credit again once you have paid back what you owed.

Characteristics

Loans can either be secured or unsecured. For secured loans, the lender holds the right to those assets you have pledged as collateral. If you cannot repay your loan, the lender can sell off your pledged assets. If there is a shortfall after the sale, you have to make up the difference still outstanding. For

- An overdraft is a revolving loan offered by banks on a secured or unsecured basis. You can draw a cheque on your current account up to the limit of the overdraft. You pay interest only on the amount used. Any unpaid interest becomes part of the outstanding overdraft the following month. Some overdraft facilities also require you to repay a minimum % of the outstanding amount owed on a monthly basis, but you can draw on the facility again so long as it is within the limit.

- A revolving credit facility is offered by finance companies. When you make a payment to a third party, the finance company checks

A matter of interest

It pays to find out how interest is calculated and how much you have to pay before you decide which loan to take. Here are some examples.

- Annuity on yearly rest is commonly used for housing loans. If you have a \$600,000 loan payable over 20 years at 5.5% per annum (pa), you will have to make 240 equal monthly repayments of \$4,184. The sum is arrived at using annuity tables that many financial institutions use.

- Flat rate is commonly used in vehicle loans or hire purchase. Take the example of a \$70,000 loan at 3.75% pa, payable over three years.

$$\begin{aligned} \text{Interest} &= 3 \text{ years} \times 0.0375 \times 70,000 \\ &= \$7,875 \end{aligned}$$

$$\begin{aligned} \text{Monthly} \\ \text{installment} &= (\$70,000 + \$7,875) \div 36 \text{ months} \\ &= \$2,164. \end{aligned}$$

- A flat rate discount in interest means interest is collected upfront. This usually applies to unsecured loans and some vehicle loans. Take the example of a \$12,000 loan at 5.5% pa, payable in one year.

$$\begin{aligned} \text{Interest} &= 0.055 \times \$12,000 \\ &= \$660 \end{aligned}$$

This sum is immediately deducted when the loan is given out while monthly installment remains at \$1,000 for 12 months.

- Fixed principal repayment means you pay a fixed amount in principal and a variable sum in interest every month. Take the example of a \$12,000 loan at 5.5% pa, payable in one year.

$$\begin{aligned} \text{Month 1} \\ \text{installment} &= \$1,000 + \$55 \\ &= \$1,055 \end{aligned}$$

$$\begin{aligned} \text{Month 2} \\ \text{installment} &= \$1,000 + \$50.42 \\ &\quad (\text{interest on outstanding only}) \\ &= \$1,050.42 \end{aligned}$$

Please bear in mind that in the above examples, the various rates used in the loan computation are applied rates. The actual rate of interest you are paying for using the loans is called the Effective Interest Rate (EIR), which may not be the same as the applied rates. You should ask the financial institutions for the EIR of the loan that you are taking.

Contest #3 (Please read the article and answer the following questions)

1. When you take a loan with a financial institution, you will usually pay back the amount owed, plus _____, over a period of time.

- a interest
- b penalty fee
- c principal
- d surcharge

2. Financial institutions usually offer either _____ or revolving loans.

- a irregular
- b term
- c regular
- d fixed

3. Interest rates for unsecured loans tend to be _____.

- a lower
- b higher
- c unchanged
- d negotiable

4. Repayment for housing loan is usually made _____.

- a in one lump sum
- b in any amount you feel like
- c any time you feel like
- d in equal monthly instalments

5. Besides interest payment for loans, there may be other costs, such as

- a Cancellation fee
- b Default charges
- c Prepayment fee
- d All of the above

Terms and Conditions

1. Every entry must be on the official entry form. No photocopies please.
2. Judges' decision is final.
3. Winners will be drawn from correct entries.

4. Winners will be notified by post.
5. Prizes are not transferable or exchangeable.
6. There will be three winners each contest. Each winner will receive a \$50 cheque and 12 issues of The Consumer.

Official Entry Form (Contest #3)

For each question, please circle the correct answer:

1. a b c d
2. a b c d
3. a b c d
4. a b c d
5. a b c d

Name: _____

NRIC: _____ Age: _____ Sex: _____

Occupation: _____

Tel: _____ Handphone: _____

Address: _____

Send your entry to:
'Dollars & Sense'
Contest #3

Consumers Association of Singapore
Ulu Pandan Community Building #05-01

170 Ghim Moh Road
Singapore 279621

Tel: 64636678 ext 14
Fax: 64679055

Email: sayit@case.org.sg

Closing date:

**Entries must reach us
by 10 December 2003**

7. Employees of the CASE, ABS, the supporting organizations and Streets, and their immediate families are not allowed to take part in this contest.
8. One entry per person.



**Next Topic on 8 Dec 2003 Monday:
Do the young need to learn the value of money?**