

## Learning About Loans, Collateral & Down Payments

### Some Loans Require More Than A Promise

Down payments are often required when taking out a loan. Examples of loans that may require down payments include mortgages, auto loans, and personal loans. For mortgages, the amount of down payment can range anywhere from 3-20%. Auto loans typically require a down payment of 10-20% of the car's total cost. Personal loans may also require a down payment; however, this amount is generally smaller than for other types of loan and can range from 5-10% depending on the lender and the borrower's credit score.

When applying for any of these types of loan, it is important to consider how much money you will need to provide upfront as a down payment. A larger down payment can help reduce the overall cost of your loan by lowering your monthly payments or reducing the amount of interest you'll pay over time. It can also help improve your chances at getting approved for the loan in question since it shows that you have some skin in the game and are thus less likely to default on your payments. Additionally, putting money down up front gives lenders more assurance that they will recoup their investment if something should go wrong with your loan agreement.

Ultimately, deciding whether or not you will need to put money down when taking out a loan depends on several factors such as credit history and income level. Most lenders will not approve a loan without some form of upfront payment; therefore, it is important to budget accordingly when applying for any type of loan to ensure that you are able to meet all requirements in addition to actually paying off the principal balance over time.

### The Size Of Your Down Payment Matters

If you're looking to purchase a home for \$300,000, you'll need to come up with a down payment. For most mortgages, a 20% down payment is required in order to secure the loan and avoid paying private mortgage insurance (PMI). A 20% down payment on a \$300,000 home would be \$60,000. That amount can seem large, but there are ways to reduce it.

If you can't come up with that much cash upfront, you may want to consider putting 10% down on the home. This would equate to a payment of \$30,000 and still get you the same loan without needing PMI. While 10% is usually the lowest acceptable amount to put down on a home purchase, utilizing this option has its drawbacks. For starters, your monthly payments may be substantially higher when making only a 10% down payment.

Using the example of the \$300K house with a 30 year fixed rate mortgage at 3%, if we use 10% as our down payment then your principal and interest payments would be slightly over \$1,268 each month for 360 months (30 years). However if we use 20% as our down payment instead of 10%, your principal and interest payments drop considerably to just under \$1,076 per month for 360 months (30 years). That's almost a difference of 200 dollars each month!

So while it may seem like there's no way around having to make those large payments up front - having an understanding of the overall financial picture that comes with different percentages of down payment can be really important when making these decisions.

The bottom line is that while having more money upfront can save money in the long run due to lower monthly payments - it often requires more upfront than many people are able to provide when buying their first home or any type of real estate. Consider speaking with your local lender about what options they have available for financing that could help reduce that initial cost if necessary so that it fits into your budget better.

### **The Bigger The Down Payment, The Lower The Interest Rate**

A down payment makes a borrower more attractive to a lender because it demonstrates the borrower's financial stability and commitment to the loan. It indicates that the borrower has enough money saved up to make an initial investment in their loan, decreasing the risk for the lender. The down payment also lowers the amount of money that needs to be borrowed from the lender, reducing their required capital outlay.

When lenders offer a loan with a down payment, they often lower interest rates for borrowers since there is less risk involved in granting them a loan. The interest rate is usually lower for larger down payments as well, incentivizing borrowers to make larger payments into their loans. This can help borrowers save on interest over time and reduce their total loan amount when fully repaid.

Additionally, the presence of a down payment motivates borrowers to make regular repayments on time due to its impact on their monthly payments and overall loan cost. Borrowers are aware that if they fail to pay back their loan on time they will lose money due to higher interest rates or other late fees charged by lenders. Therefore, making timely repayments and paying off loans quicker becomes an incentive for borrowers who have made a down payment into their loan.

STANDARDS: 5.12.6a, 5.12.6b, 5.12.6c, 5.12.6d