Understanding Loans

A **loan** is a type of debt. In a loan, the borrower borrows an initial amount of money, called the *principal*, from the lender, and is obligated to pay back an equal amount of money to the lender at a later time. Typically, the money is paid back in regular *installments*, or partial repayments.

A loan is generally provided at a cost, referred to as **interest**, on the debt. In a legal loan, each of these obligations and restrictions is enforced by *loan contract*, which can also place the borrower under additional restrictions known as *loan covenants.*

Financial institutions use the same tools for calculating risk and interest rates for borrowers as they use for credit card offers.

Reasons for Taking out a Loan:

Debt consolidation: If you have multiple debts at high interest rates, it might work to your advantage to pull all of your debts together under one lower-interest loan.

Making large purchases: Because of the large amount of money involved, buying a home or car is often done through a loan.

Attending school: Many students use federal loans to attend college, trade school, or graduate school.

Additional reasons: Starting or expanding a business, making home improvements, planning a wedding, travel.[83]

> **Note:** Loan debts can be just as difficult as credit cards to pay down and any debt that has become overwhelming can become the source of a great deal of anxiety and stress. Later in this course, we will develop tools to address personal debts and create a person-centered plan to pay off debts.

[83] Original material from Peerlink National Technical Assistance Center.