**Consumer credit** takes the form of loans extended to people who borrow money to finance the purchase of cars, furniture, appliances, jewelry, electronics, and other items.

**I. Installment Loan** (or **Closed-End Credit)**

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ involves borrowing a set amount of money up front and paying a series of equal installments (payments) until the loan is paid off. Furniture and appliances may be financed through closed-end credit, sometimes called \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_.

Installment loans set up under closed-end credit often are based on **add-on interest**. This means that if an amount ***P*** is borrowed, the annual interest rate is to be ***r*,** and payments will extend over ***t*** years, then the required interest comes from **simple** interest.

**EXAMPLE:** Yasmin buys $4700 worth of furniture and appliances for her first apartment. She pays $940 down and agrees to pay the balance at 6% add-on interest for 2 years. Find:

1. the total amount to be repaid
2. the monthly payment
3. the total cost for the furniture and appliances plus interest
4. The total amount to be repaid is based off the amount of money borrowed, called the **amount to be financed (principal)**. You must consider the **down payment** first!

Purchase price – down payment = Amount borrowed or financed (Principal, or *P*) **[notecard!]**

Amount to be repaid (future value) = **[notecard!]**

1. **[notecard!]**
2. Total cost plus interest (*C*) = Down payment + total amount repaid (future value, *A*)

**[notecard!]**

**EXAMPLE:** The total purchase price of a new home entertainment system is $14,270. If the down payment is $2600 and the balance is to be financed over 36 months at 6% add-on interest, what is the monthly payment? (round to the nearest cent as needed)

* Purchase price – down payment = Amount borrowed or financed (Principal, or *P*) **[notecard!]**
* Amount repaid (future value) = **[notecard!]**
* **[notecard!]**

**II. Revolving Loan** (or **Open-End Credit**)

With \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_, there is no fixed number of installments – the consumer continues paying until no balance is owed. Examples include department store charge accounts and charge cards such as MasterCard and VISA. With a typical open-end credit account, a credit limit is established initially and the consumer can make any purchases during a month (up to the credit limit).

At the end of each billing period (normally once a month), the customer receives an **itemized bill**, a statement listing purchases and cash advances, the total balance owed, the minimum payment required, and perhaps other account information.

Any charges beyond cash advances and prices of items purchased are called \_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_. Finance charges may include interest, annual fees, credit insurance, late fees, limit fees, and etc.

Most open-end lenders use a method of calculating finance charges called the \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_. It considers balances on all days of the billing period. This is a weighted average that multiplies the balance time the number of days.

**[notecard!]**

**EXAMPLE:** The activity on a credit card account for one billing period is given below. If the previous balance (on March 3) was **$348.57**, and the bank charges **1.5%** per month on the average daily balance, then find

1. the average daily balance for the next billing period (April 3)
2. the finance charge for the April 3 billing.
3. the account balance for the billing date of April 3.

March 3 Balance $348.57

March 7 Payment $65.00

March 13 Movies $48.12

March 18 Eat out $23.58

March 28 Bus pass $64.00

April 2 Order pizza $28.35

1. **Make a table of the running balance**

**Then take the balance and multiply (times) the number of days of the balance:**

|  |  |  |  |
| --- | --- | --- | --- |
| **Date** | **Running Balance** | **Number of Days** |  |
| March 3 |  |  |  |
| March 7 |  |  |  |
| March 13 |  |  |  |
| March 18 |  |  |  |
| March 28 |  |  |  |
| April 2 |  |  |  |
|  | **Totals:** |  |  |

(round to the nearest cent)

Finance charge for April 3 bill will be 1.5% of average daily balance of $\_\_\_\_\_\_\_\_\_\_\_\_.

**Finance Charge =**

(round to the nearest cent)

1. Account balance on April 3 bill is latest running balance plus the finance charge.

**Account Balance at time of bill on April 3 =**

(round to the nearest cent)

**EXAMPLE:** At the beginning of a 31-day billing period, Sandra has an unpaid balance of $740 on her credit card. Three days before the end of the billing period, she pays $200. Find her finance charge at 3.5% per month using the average daily balance method.

(Assume no purchases or returns are made in the billing period.)

* Three days before the end of the billing period, Sandra pays $200

|  |  |  |  |
| --- | --- | --- | --- |
| **Date** | **Running Balance** | **Number of Days** |  |
| **Beginning of**  **31-day billing period** |  |  |  |
| **Three days before the end of the billing period** |  |  |  |
|  | **Totals:** |  |  |

Sandra will pay 3.5 % finance charge based on the average daily balance of $\_\_\_\_\_\_\_\_\_\_\_\_\_

**Finance Charge =**

(round to the nearest cent)

NOTE: For the test, make sure you know how many days are in each month!

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Jan** | **Feb** | **Mar** | **Apr** | **May** | **Jun** | **Jul** | **Aug** | **Sep** | **Oct** | **Nov** | **Dec** |
|  |  |  |  |  |  |  |  |  |  |  |  |