1.5

Managing Resources

Borrowing Money

Learning Outcome Notes

LO 1.5 - Identify reasons for saving and borrowing money, relate the reasons to determining appropriate sources of finance with respect to their purpose, costs and risks.

CHAPTER QUESTIONS

By the end of this learning outcome, you should be able to do the following -

1. Define the term saving and borrowing and the different between the two.
2. Outline the reason for borrowing.
3. Explain the different sources of finance and apply them to different spending.
4. List why and where people save.
5. List the services and products that are provided by financial institutions.
6. Explain the factors that a bank considers before giving a loan.
7. Outline the right and responsibilities of borrowers.
8. Calculate the interest on savings.
9. List the taxes that are applied to savings and when is the best time to save.

NOTE – This Learning outcome can be linked with Economic Indicators (1.1) and resources.

SHOULD WE BORROW MONEY

It may not be always possible to buy what we need or want. One way to over come this is to borrow money -

Borrowing Def This means getting the money from a person or financial institution in exchange for a promise to pay it back with interest in the future (*agreed time)

Financial Cost Def Interest is the financial accost of borrowing. This is the extra that has to be paid back on top of the loan.

Before we borrow money, we should ask ourselves the following questions -

1. Do I relay need this item?
2. Can I get the money another way?
3. How much will it cost
4. Can I afford the repayments?

Instalment Def This is a fixed sum of money that must be paid back over several payments spread over an agreed period of time.

Asset Def This is anything owned by a person or business that has a monetary value.

Collateral Def This is an asset that is used as security when getting a loan. It you can't repay the loan this asset (security) will be sold to repay back the loan to bank.

REASONS FOR HOUSEHOLD BORROWING

The following are some reasons why households borrow money -

1. To pay for expensive items like a house
2. To deal with short falls or deficits
3. For emergencies

BORROWING MONEY

Borrowers need to match they type of lean with the type of need. This is known as the matching concept. See the table below

Need	Example	Repayment Duration	Source of Finance
Short term	Budget Deficit	Within one year	Bank over draft credit cards
Medium Term	Purchase of a car	One to five years	Medium term loan, Hire Purchases, Leasing
Long Term	Purchases of a house	More than Five Years	Mortgage

TYPES OF BORROWING FOR HOUSEHOLD AND BUSINESS

Short Term

1. Bank Overdraft

This is when the account holder is given permission by their bank to withdraw more money from their account then is in it. It is an agreement with the bank to take out extra money up to a certain limit.

2. *Credit Cards*

Card holders can buy now and pay later. This is an expensive source of finance as the interest charged can be very high.

Medium Term

1. *Medium Term Loan*

This source of finance can be arranged from banks, building societies and credit unions. Borrower usually make fixed repayment on a monthly basis over an agreed period of time. This repayment includes the interest and the loan.

2. Hire Purchases

This is when the borrower pays a deposit and an agreed number of instalments. Ownership of the asset doesn't pass to the buyer until they have paid the very las instalment. There is no security required but it can be a very expensive source of finance.

3. Leasing

This involves renting the asset. The person can use the asset straight away and will pay fixed regular payments to the leasing company. They will never own the asset.

Long Term

1. Long Term Loan/Mortgage

This is usually money borrowed to buy a house. The borrower is entering into a contract with the bank to repay back the loan plus interest. The house is usually used as collateral if the loan can't be paid back the house will be sold to pay back the debt. These loans are usually repaid back between 15 and 25 years.

BORROWING FROM MONEY LENDERS

Money Lenders — **Def** These are individuals (or companies) other that financial institution who lends money. They must have a licence and follow strict rules.

There are unlicensed money lenders. They break the laws and charge very hight interest rate (some over 100%). The can use fear an intimidation to get repaid the loans they give so should be avoided

APPLYING FOR A LOAN

Before you borrow money, you should ask yourself the following questions -

1. How much do you need to borrow.
2. Can you afford the repayment each week or month.
3. How long do you have to repay the loan.
4. Which financial institution is given the best rates.

When you want to get a loan you will need to fill in an online application form (credit union) or you can go in in person and fill in the application form. The form will ask the following questions

1. Personal details
2. Address
3. Employment details
4. Saving records
5. Borrowing history
6. Purpose of the loan

Before being given a loan the financial institution will look at the creditworthiness of the applicant

Creditworthiness Def This looks at a person ability to repay a loan. It is based on their past borrowing and saving record. If they have paid previous loans on time and if the save on a regular basis

If your creditworthiness is not good the applicant can get a guarantor

Guarantor Def This is a person usually a parent or guardian who says they will repay the loan if the applicant can't or doesn't pay it back

HOW TO CALCUALTE INTEREST

Please have a look at the tutorial videos and resources on the class website to help calculate the interest on a loan

RIGHTS AND RISK OF BORROWING

The following are some of the rights of a borrower when getting a loan and risk of the borrower if the loan is not repaid -

Rights	Risks
1. Written documents of the agreement	1. May lose the collateral if not repaid
2. Cooling off period 10 – 14 days	2. Creditworthiness may be affected
3. Know the cash and total credit price	3. May be fined or taken to jail
4. Know the number instalments and amount	

AGENCIES TO HELP BORROWERS

There are organisation or agencies that can help people who get into financial difficulty. These include -

1. MABS
2. ISI

<u>Money Advice and Budgeting Service (MABS)</u>

1. This is a confidential and states free agency who give money advice and help people who are having money problems.
2. They have a website that gives useful information
3. Money advisors give advice to people who are in financial difficulty (Debt)

<u>Insolvency Service of Ireland (ISI)</u>

1. This was set in 2012 under the personal insolvency act.
2. It is an independent body that help people who are unable to repay their debt.

Insolvency Def This is when a person is unable to repay their debt.

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Past Exam Questions and Answers

NOTE – Very Important

It is very important when answering exams questions use the following steps -

1. That you know the information for the learning outcome
2. That you understand the information from the learning outcome
3. That you can apply the information from the learning outcome to the question
4. Be able to give at least two full sentences for your answer (Fill up the space)

Questions are changing from rote learning to applying the knowledge to the Question

QUESTIONS

2022 - Question 17

When interest rates are high, it encourages saving and when interest rate are low, it encourages borrowing.

(i) What is interest?

(ii) Outline one reason why low interest rate encourage borrowing.

2019 – Question 3

Suggest a suitable source of finance to make the following consumer purchases

Purchases	Source of Finance
House	
Car	
Groceries	

SUGGESTED SOLUTIONS

2022 - Question 17

When interest rates are high, it encourages saving and when interest rate are low, it encourages borrowing.

(i) What is interest?

Interest is the reward given by a financial institution to customer for saving money with
them. It is also the financial cost (fee) of borrowing money and is the extra money that is
paid back. When you borrow money Interest is generally expressed as a percentage, such as
an annual percentage rate (APR).

(ii) Outline one reason why low interest rate encourage borrowing.

When interest rates are low it means the cost of borrowing is low. Individuals and businesses
will be more likely to borrow money because they will not have to pay back as much money
when interest rates are low i.e., lower repayments.

2019 – Question 3

Suggest a suitable source of finance to make the following consumer purchases -

Purchases	**Source of Finance**
House	Mortgage
Car	Hire Purchase
Groceries	Bank overdraft