



## Module 3

### Session 5



# Borrowing & Interest

## Lesson summary

Borrowing money is something that most people will experience in their lives. This session helps us to understand the different types of lending products and how interest rates can affect our monthly repayments.



## Learning Objectives

To be able to understand the basics of APR and borrowing money.

To be able to understand the impact of changing interest rates.

To be able to discuss the pros and cons of financial products in a given scenario.

## Lesson preparation

1. HSBC PowerPoint slides to facilitate lesson: Module 3 Session 5 Borrowing Money
2. HSBC Worksheet M3W5 used to complete activity
3. HSBC Stretch Challenge M3SC5 to further embed learning as homework or a class project
4. Check the current bank of England base rate to support lesson conversations
5. Prepare examples where you have had to borrow money and taken time to research different options. Think about an example for short, medium and long term borrowing if possible

## Slide 2: Borrowing Money – 4 mins



**Ask the group: What do we mean by borrowing money?**

**CLICK to reveal** – Key facts about borrowing money:

- You are given money by the bank on the condition that you pay it back
- You sign a legally binding contract detailing when and how to repay the money
- You are usually charged interest to cover the cost of borrowing the money
- The higher the interest rate the more you will need to pay back



**Ask the group: Does anyone know what an interest rate is?**

**CLICK to reveal** – An interest rate is an amount of money, normally displayed as a percentage, which you are either charged for borrowing (DEBIT INTEREST), or you receive for saving an amount of money (CREDIT INTEREST).

- **Debit interest:** is an amount that you are charged for borrowing money
- **Credit interest:** is an amount that you will receive when you save money with a bank or building society

There is an overall standard base interest rate which since 1997 has been set by the Bank of England, this is used to steer the general economy. This has risen recently from a low of 0.1% during lockdown but is still far below the historic highs of 14% seen in the 1980s and 1990s.



**Ask the group: Does anybody know what today's base rate is?**

**You will need to prepare this answer in advance as it will be reviewed every 6 weeks. You could run as a multiple choice.**

## Lesson commentary

**CLICK to reveal** – Discuss ideas on why you might need to borrow money:

- New car/car repair
- Mortgage
- Pay off other debts
- Holiday
- DIY project
- New furniture
- Unexpected costs
- Start a business
- Wedding

Interest rates apply to most financial products, so it is important to match the right financial products to your goals. This means you need to research what the interest rates are and how they function so you can find the best one for your situation.

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## Slide 3: What is APR? – 3 mins



### **Ask the group: What is APR?**

**CLICK to reveal** – Annual Percentage Rate

**CLICK to reveal** – APR refers to the total cost of your borrowing for a year. It includes the standard fees and interest you'll have to pay.



### **Ask the group: How is it calculated?**

**CLICK to reveal** – As you can see this is a complex formula, it isn't something you need to learn as financial providers must publish the APR for you.

When looking to borrow money you ideally want to look for products with the lowest APR.



**Ask the group: What do you think is the maximum amount of APR do you think a firm in the UK is allowed to charge? (Multiple Choice)**

**Answers:**

1. 0.1% per day
2. 0.25% per day
3. 0.6% per day
4. **0.8% per day – equates to an annual rate of 1,250% APR**



**Ask the group: Do you think all customers get offered the same APR?**

**Answers:**

1. Not everyone gets offered the same rates for the same products
2. Customers with a better credit rating are likely to be rewarded with a cheaper APR. They are lower risk to the bank
3. Customers with a lower credit score could be seen as more of a risk so have a higher APR offered to manage the risk. So if you have a low credit score then the cost to borrow money could be higher
4. Secured lending – connecting an asset such as your house to the amount you want to borrow (in case you can't pay back the loan) lowers the risk
5. Unsecured lending – allows you to borrow money once the lender has checked that you are able to afford the repayments but you don't need to connect an asset such as your house to the borrowing
6. Better rates are offered to customers who meet other criteria, such as income, loyalty, or those who have premium bank accounts
7. Only 51% of customers need to be offered the advertised rate to advertise it publicly

## Slide 4: What is the impact of changing interest rates? – 10 mins



**Group work: Worksheet M3W5. In table groups, ask young people to discuss the impact of changing interest rates and record their answers on the worksheet.**

**Optional delivery:**

- Assign a stakeholder type to each group (borrower/lender/society) and ask them to discuss the impact of changing interest rates for that stakeholder; or
- Assign an interest level to each group (high or low interest) and ask them to discuss the impact of this for all stakeholders (borrower/lender/society); or
- Assign an individual interest rate and stakeholder to each group and ask them to discuss how that level of interest will affect the stakeholder

**After groups have fed back their answers, confirm actual impact of changing interest rates on the slide:**

	Borrowers	Lenders	Society
<b>Interest Rates are High</b>	Charged more for borrowing monthly Increased monthly payments May have to borrow less More tempting to save?	Make higher returns off lending products May see less new lending products sold Need to reward savers with more interest	Bills become more expensive More people in financial difficulty Cut back spending
<b>Interest Rates are Low</b>	More affordable to borrow Decreased monthly payments May borrow higher amounts Less incentive to save?	Increase in new lending products sold Customers spend more and save less Less capital to lend to borrowers	May put off paying off debts May put off emergency savings May stretch finances only based on current interest rates



**Ask the group: For your current situation would you prefer interest rates to be high or low?**

## Slide 5: Short Term Borrowing – 5 mins

**Short-term borrowing is usually paid back within 1 year after borrowing.**



**Ask the group: Read through the table on the screen and ask the young people to match the headers at the bottom to the pros and cons.**

### **CLICK to reveal Column 1 – Friends and Family**

This could be a whip-round from your friends, a visit to the 'Bank of Mum and Dad', or a generous member of the family.

**Pros:** You can set your own terms as to when and how much you pay them back. This means that it could also become a medium or long-term loan. Because you agree the loan, there may be little to no interest on it.

**Cons:** You need to make sure the money is paid back, otherwise it could cause rifts in your relationship.

### **CLICK to reveal Column 2 – Arranged Overdrafts**

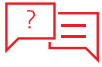
This is a way to borrow money through your current account. You'll go into an overdraft if you make a withdrawal or purchase that takes you below your available balance.

An '**arranged**' overdraft is one approved in advance with your bank. An '**unarranged**' overdraft is when you go overdrawn without an arranged overdraft limit in place, or you go over your arranged overdraft. If you go overdrawn without having an arranged overdraft in place it may negatively affect your ability to borrow money in future.

**Pros:** Flexible way to borrow money over a short period. It only relates to what you need to spend.

**Cons:** Interest and daily fees if you misuse. It can negatively impact your credit score if you overuse your overdraft.

### CLICK to reveal Column 3 – Buy Now Pay Later



#### Ask the group: What do you think we mean by the term “buy now-pay later”

A BNPL provider pays for your item for you and then you owe them the money back at a later date as a debt.

This is mostly done online but is starting to be available instore for certain retailers.

Normally the BNPL lender offers you a 0% interest contract that you pay off in 3-6 months. Contracts do vary. This means you don't pay anything extra to the BNPL company. This can help people pay off an item they need over an extended period of time when they are having cash flow issues.

Like all debts, if you miss your payment dates you will incur late payment fees and it could have an impact on your ability to borrow money in the future. So you will need to be responsible and plan your spend and use of these services as the amounts can quickly build up.

If you choose to use BNPL instead of a credit card then you won't get the same consumer protection if there is an issue with the company or item. Electronics, fashion and appliances are the most popular items bought through BNPL arrangements. So you need to consider are these purchases worth getting into debt for?

**Pros:** Spread the cost of an item over 3/6 months to make it affordable. Often 0% APR making it seem like an attractive way to buy something.

**Cons:** No procedures to stop you signing up for too many. May not realise what you have signed up for. Fees for late payments.

### CLICK to reveal Column 4 – Pay day Lender

These are designed to lend you money until your next payday but can sometimes run for longer. Please be wary and take note of the interest rate that is applied to payday loans. You could end up paying back a great deal more than you borrowed.

**Pros:** Seen as a quick fix. **Warning:** If you're already in financial difficulty, speak to your bank about how they can help you instead of resorting to this type of borrowing.

**Cons:** Extremely high APR. Trapped in increasing repayments.

## Slide 6: Medium Term Borrowing – 5 mins

**Medium-term borrowing is usually paid back within 1-5 years.**



**Ask the group: Identify which borrowing type matches the pros and cons, then run through to confirm understanding.**

### **CLICK to reveal Column 1 – Credit Cards**

Credit cards allow you to buy things now and pay later. You can spend for a month and then receive your statement. At this point you can either pay it all back to avoid paying interest or pay off the minimum payment to meet your contractual obligations.

#### **Pros:**

- They can also offer protection on payments between £100 and £30,000. This means if you need a refund, or if the company goes bust, the credit card provider can refund you quickly
- You can earn points or rewards to use for later purchases
- You can build your credit score to make future borrowing cheaper
- You can choose to pay as much as you want to between the maximum and minimum payment each month depending on your situation

#### **Cons:**

- The interest can increase the debt if you only make minimum payments. This will increase the time required to pay off the debt and make the purchase more expensive
- Do you have the will power to not use the credit card when tempted to spend?



### **CLICK to reveal Column 2 – Personal Loans**

This is where you borrow a set amount of money for an agreed amount of time; usually between 1 and 7 years. This can be for many uses but you can't use a personal loan to borrow money for a house deposit. You pay back the full amount plus interest at an agreed rate. The amount of interest is calculated at the beginning when you take out the loan so you know exactly what you owe each month.

#### **Pros:**

- You can borrow without having to provide security
- Payments are fixed for the duration of the loan so you plan your budget
- Most providers will let you pay off your loan quicker if you find you are able to do so. This means you could end up finishing the loan quicker and pay back less interest

#### **Cons:**

- You need to be able to afford the loan for its duration
- If you miss a repayment this will negatively affect your credit score which will make borrowing harder in the future

### **CLICK to reveal Column 3 – Things to consider when borrowing money**

- Are the payments fixed or flexible?
- Can I make overpayments to pay it off sooner?
- Can I afford it in my budget?
- Don't be pressured to sign up for any borrowing
- Don't make assumptions, if you don't understand then keep asking questions
- If you miss a repayment it will negatively affect your credit score which will make borrowing harder in the future

## Slide 7: Flexibility vs Fixed Payments – 3 mins



**Ask the group: Read the scenario, ask the group to make an initial vote on whether the credit card or personal loan would be the best way to borrow the money.**

**Explore the scenario:**

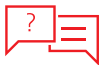
**CLICK to reveal** – Payment terms

- Credit card: Flexible – you are required to pay at least 3% of the balance
- Personal loan: Fixed payment of £75 per month

**CLICK to reveal** – Interest rates

- Credit card: Interest added to the outstanding balance each month
- Personal loan: Interest agreed at the start of the contract and added to the total amount borrowed

**CLICK to reveal** – Payment term/duration



**Ask the group: How long do you think it would take to pay off the credit card debt if only paying the minimum amount each month?**

**CLICK to reveal answer** – 27 years and 7 months (and an extra £4,192 spent in interest).

Personal loan: Duration chosen at the beginning of the loan – in this case 5 years and an extra £1,515 spent in interest by revealing more information, note the difference between paying off the loan vs credit card.



**Ask the group: The loan is the cheaper option but what is the value of the additional consumer protection. Which option would you go with?**



**Ask the group: What else could you do instead to pay the debt off wisely?**

**Discuss then CLICK to reveal answers:**

- Remember that you may be able to overpay both to clear the interest quicker!
  - If you pay the credit card off at £108 per month (not just the minimum %) you would have paid it back in 3 years and only an extra £879 spent on interest. That is a saving of £3,313
  - If you pay £108 off the loan each month instead of £75, it would be paid off in 2 years and only an extra £943 spent on interest. That is a saving of £716
  - You could buy the holiday with credit card to gain the consumer protection and then use the loan to pay off the credit card instead. This means you get the best of both worlds
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## Slide 8: Long Term Borrowing – 5 mins

**Long term borrowing is usually paid back between 5-40 years**

### **Mortgages**

You'll usually need a mortgage when you're ready to buy your first home and the property provides security for the loan. When you apply for a mortgage you will need to look at how much you need to borrow and over how many years. Some mortgage terms can be up to 40 years if you are young enough which can help keep repayments low.

When taking out your mortgage, you need to decide on which product you want. If you want to be sure you can afford your repayments, you can fix your interest rate over 2yrs, 5yrs, 10yrs or even 20yrs.

Alternatively you can choose to track the Bank of England's base rate – taking a chance that this interest rate will be lower than being on a fixed rate.

## Lesson commentary

### **CLICK to reveal:**

#### **Pros:**

- A mortgage enables you to borrow a lot of money so that you can buy your first home
- The more deposit you save the better interest rates as there is less risk to the bank. (you'll usually need at least a 5% deposit on the value of your new home)
- As you pay off the mortgage you will own more of the house and each time the fixed term of your mortgage term expires you can negotiate a better deal

#### **Cons:**

- You must save a deposit, usually at least 5% of the property value or purchase price
- Interest rates can go up which could increase your monthly bill if you have not opted for a fixed interest rate or could increase your mortgage payments when you come to the end of your mortgage term
- If you are not able to continue paying your mortgage, the house will need to be sold to pay off the remaining debt

## **Hire Purchase**

Often associated with cars, this allows you to make monthly repayments on a car. At the end of the term of the contract you then have the option to pay a final balloon payment to purchase the car or you can choose to give the car back. You may need to borrow money if you can't afford to buy the car outright at the end of the term.

### **CLICK to reveal:**

#### **Pros:**

- You can buy a car with just the deposit amount (usually 10%) which may allow you to get a better car than you could otherwise
- Manageable monthly repayments
- Fixed payment for a fixed duration

#### **Cons:**

- You will not own the car until the final payment with a final payment due to transfer ownership
- You pay more due to interest charged on the purchase price
- If you are unable to continue paying, the car may be taken away and if you can't afford the final payment to own the car then again you will have to give the car back

**CLICK to reveal – Things we need to consider when borrowing money over the long term:**

**Why do we need to pay a deposit for long term borrowing?**

To be able to borrow a large amount over a longer period of time we need to share some of the risk with the financial institution. The more deposit you can provide the less risk to the lender which often results in lower interest rates.

**Why do we lose our assets if we are unable to pay?**

The debt is secured against those assets. This means you and financial institution agree to sell the assets to clear the remaining debt. This gives the customer a way to end their debt if their financial situation changes.

**What safeguards could I consider?**

Make sure you have an emergency fund or savings that you could fall back on and consider a protection policy should something unforeseen happen such as ill health. Seek financial guidance if you are unsure.

**How does not paying of my debts impact my credit record?**

Failing to pay off your debts will negatively impact your credit score and financial health.

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## Slide 9: Buying Options – 10 mins



**Group work: Review Charlie's scenario**

**CLICK to reveal** – The four borrowing options that Charlie could consider:

- Credit card
- Personal loan
- Hire purchase
- Payday lender

Ask the young people to discuss in groups which of these types of lending they would recommend to Charlie and why and then feedback to class.

## Slide 10: Buying Options – Calculations – 5 mins

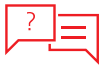


**Continuing with the case study of borrowing money for a £5,000 car, use this slide to work through the figures to see which purchase method is the best decision. For each option calculate how much Charlie will have to repay in total:**

**CLICK to reveal – Credit Card**

Interest is calculated monthly on the remaining balance after each payment.

- Typical interest rate 18.9%
- Monthly repayments: £180
- **Total Repayable = £6,450**



**Ask the group: What is the cost of the loan?**

**Answer: £1,450 in interest**

**CLICK to reveal – Personal Loan**

Can vary and are subject to application / personal requirements

- Typical interest rate 7.9%
- Monthly repayments: £156
- **Total Repayable = £5,609**



**Ask the group: What is the cost of the loan?**

**Answer: £609 in interest**

## Lesson commentary

### **CLICK to reveal – Hire Purchase**

Can vary considerably and are subject to application / personal requirements

- Typical interest rate 10.9%
- Monthly repayments: £183
- **Total Repayable = £6,589**



**Ask the group: What is the cost of the loan?**

**Answer: £1,589 in interest**

### **CLICK to reveal – Payday Lender**

Often charge the maximum amount of daily APR allowed. While it is unlikely they would borrow over a term as long as 3yrs, if we borrowed the money for 1 year and 11 months it would cost us £1,220 per month and over £22,642 total repayable

- Interest rates up to 1250% (this is the maximum allowable)
- Monthly repayments: £1,220
- **Total Repayable = £22,642**



**Ask the group: What is the cost of the loan?**

**Answer: £17,642 in interest**

**The personal loan is the cheapest option to borrow the £5,000 and because you have a fixed amount to pay each month you can budget for this in your financial plans.**

# Slide 11: Stretch Challenge

**This can be used as you see fit for a homework, group project or additional lesson during school hours. Stretch Challenge worksheet M3SC5 provided to record answers.**

Using a comparison website or your own bank, research the APR on 4 methods of borrowing money. Now consider that a personal loan in the year 2000 had an interest rate of 15%.

- How expensive would it be to borrow £3,000 on a personal loan in the year 2000?
- How do you think high interest rates affect people's financial health?
- How does this compare to borrowing money for a personal loan of £3,000 today?
- What steps can we take to protect our finances from high interest rates?

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**Module 3**  
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**Stretch Challenge:  
Interest Rates**



Using a comparison website or your own bank, research APR for the following products:

Credit Card	
£3000 Personal Loan	
Higher Rate	
Additional Rate	


In 2000, Banks offered Personal Loans charging 15% APR.  
How much debt would you accumulate if you borrowed that money now and in 2000?

Year 2000: Personal Loan 15%	
Current Year Personal Loan	



Essex Year of   **HSBC UK** Name: \_\_\_\_\_

In 1979, The Bank of England Standard Variable rate hit 17%. How do you think this affected peoples borrowing and financial health? What steps can we take to protect ourself from high interest rates in the future?



M3SC5 Name: \_\_\_\_\_



# Worksheet

**Print the required amount of worksheets or complete these digitally if able to.**



**Group work: Worksheet M3W5. In table groups young people to discuss the impact of changing interest rates and record their thoughts in the worksheet.**

**Optional delivery:**

- Each group assigned a stakeholder (Borrower/Lender/Society) and can discuss that stakeholder for both high and low interest rates
- Each group assigned either high or low interest and can discuss for all stakeholders
- Each group has a separate interest rate and stakeholder

After groups have fed back their answers, confirm the actual impact of changing interest rates on the slide.



**Ask the group: For your current situation would you prefer interest rates to be high or low?**

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**Module 3**  
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**Worksheet:**  
What is the impact of changing interest rates?

Consider the impact of changing interest rates if you were going to borrow some money, as a financial lender or for society as a whole:

	Borrowers	Lenders	Society
Interest Rates are High			
Interest Rates are Low			

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