Transcript

Preparing Your Child To Make Borrowing Decisions

Let’s take a look at some ways you can talk to your teen about identifying times when it might be a good idea to borrow money and times when it might not.

You can begin by explaining the basics:

Most teens probably know that debt is money owed by a borrower to a lender, but they might not understand that a loan isn’t free money—it actually costs money too

We look at ways you can help your child understand how debt works in more detail in another video,

http://www.bettermoneyhabits.com/teaching-kids-money/credit-basics-for-kids/help-your-child-understand-how-loans-work.html

But for now, you can explain that when she takes out a loan, she’ll have to repay it over a certain amount of time—typically in monthly installments—and she’ll have to pay interest to her lender too.

So even if she gets a loan with affordable monthly payments, she’ll end up paying more than the original cost because she’ll also be paying interest.

Now, the basic idea behind debt is pretty easy, but knowing when it might be a good idea to borrow money and take on debt and when it might not be can be a little more complicated.

When your teen is considering borrowing money to make a purchase, he can ask himself a few questions:

Is what he's buying truly necessary?

Does he have room in his budget to cover the monthly payments?

Could he save money for a few months to pay for it instead of borrowing for it?

And, after totaling the additional amount of money he'll pay in interest over time—will the purchase still be worth it?

With these questions in mind, you can explore some borrowing decisions with your teen.

For example, taking out student loans to pay for college could be a good reason to borrow money if the education leads to a job with a good salary.

But, if the amount taken out in loans is overwhelming, or if the student never graduates, repaying these loans could become a significant burden.

Another example would be taking on large amounts of debt to go on a big vacation or a shopping spree. These might not be the best things to go into debt for because they're examples of things that aren't really necessary– these are things your teen might want, but not necessarily need. Not only can the repayments stress your teen's future budget–– but, with the added interest, those purchases will end up costing him a lot more than if he had saved up for them in advance.

Another example to explore could be payday loans. These are basically short-term cash loans that a borrower is expected to pay back with her next paycheck. But these loans tend to have very high interest rates and fees and the result of taking out one of these loans is that the borrower ends up taking home a lot less of her pay. And, unfortunately, many payday borrowers get stuck in a cycle of debt that causes them to take out loan after loan. A better idea would be keeping some money saved for emergencies so your teen never has to resort to a payday loan for unexpected expenses.

In the next few years your teen might encounter offers for different types of debt. Things like credit card offers, student loans, or auto loans.

By teaching teens to stop and ask themselves a few questions about:

whether the loan is necessary,

do they have room in their budget to cover future payments,

could they save instead of borrow,

and if borrowing for a purchase is worth it after paying the extra interest and fees,

you can help them avoid borrowing money impulsively and taking on too much debt.

And ultimately, if your kids are good at managing debt, they'll be in a better position when the stakes are higher. Like when applying for a mortgage on a home. Not only will they be better prepared to make responsible borrowing decisions,

but with a higher credit score, they'll likely be able to negotiate lower interest rates which can save them a lot of money in the future.