Activity #2: How Much Does Credit Really Cost?

Credit uses some very tricky math. You need to use percents, decimals, addition, multiplication, and division to really understand it. Do you hate doing math? That’s good news for some businesses! They don’t want you to understand how credit works. That way you’ll agree to give them lots of money without even knowing how much! Different businesses charge very different amounts for credit. This can make a huge difference in how much you are really paying for something you want.

Because it’s so easy to trick people using credit, the government requires all loan contracts and credit offers to contain certain information. You can find the words Annual Percentage Rate (or APR) on these forms. That tells you how much interest you will pay every year. Usually, you will also find the total amount of interest you are paying for the credit or loan. Be sure to look at these numbers carefully, even if the salesperson pressures you or talks about low monthly payments! If you shop around before signing any contracts, you can save yourself a lot of money. Rent-to-own stores don’t even talk about interest, because, technically, they are not giving you a loan. But you should look closely at their brochures and contracts. The brochures are required by law to tell you the total price you will pay before you own what you are renting. You might be surprised to find that you are paying at least three or four times what the item is really worth!

Here’s an example of how different interest rates can be. Let’s say you want to buy a new television set that costs $350 at the store, but you can only afford to pay $35 per month. After shopping around, you might find that you have the following choices.

Choice #1: Wait and Save. If you save your money for ten months, you can buy the television without using credit. This means that you will have to wait for the new television. The total cost for the television would be $350.

Choice #2: Use Store Credit. If the store that had a 21% APR, your interest payments would be approximately $73. You would get the television right away, but the total cost would be $423. You would own the television after 12 months of payments.

Choice #3: Rent-to-Own. If you had trouble getting credit at the store, you might decide to go to a rent-to-own business. They would let you have the television for only $8.99 per week. This can sound very good, because it doesn’t sound like much money and you can have the television right away. But if you read the contract carefully, you’ll find out that the total cost of the same television is $934.96. You also would not own it for two years, and if you missed any payments—even after paying hundreds of dollars, they could take the television back and you would have nothing. Because renting-to-own is not considered a credit business, these companies are not controlled by the same laws as the store. If they were, the Annual Percentage Rate would be more than 46%, which would be illegal!