



## *Intro to Debt*

### Goals:

- Types of debt
- Debt-to-income ratio
- Fringe & predatory services
- Rights in debt collection
- Bankruptcy

### Fact Pattern – Luis Debt

- Earns \$2,000/month
- Spends \$1,150/month on debt
- Has a payday loan, car loan and credit cards



# Types of Debt

- **Unsecured:** no collateral (credit card or CGF loan)
  - **Collateral:** pledged as security for a loan
- **Secured:** collateral
- **Revolving:** a loan with a credit limit that can be borrowed multiple times (e.g., credit card)
- **Installment:** lump sum + recurring payments of principal & interest
- **Mortgage:** A long-term loan to buy a house – house is used as collateral
- **Collection:** When a delinquent account is sold to a third-party to collect on a debt
- **Public Record:** When a creditor takes a delinquent account to court AND wins a judgment
- **Supercreditors:** Accounts, such as tax liens & student loans that cannot be discharged in bankruptcy



## Good Debt vs. Bad Debt:

### Good debt is a tool:

- Smooth cash flow
  - Life without a credit card is hard
- Make key investments

### Bad debt is a barrier:

- Financial drain
- Source of stress
- Prevent progress toward goals

### Good Debt

- Buying a home
- Paying for college
- Business loan

### Middle Ground Credit Cards

If you use only 30% of your total credit, and pay down the balance each month, credit cards can be good debt. If you maintain a balance on the card, it is bad debt.

### Bad Debt

- Any debt you cannot afford
- Fringe and predatory services
- Purchase of quickly depreciating assets, such as furniture

## Fringe & Predatory Services:

\$100 billion/year industry

- Payday lender: quick cash, high interest rates (260% in Rhode Island)
- Rent-to-own: easy to sign up, expensive to use
- Pre-paid Debit Card: fees; make it harder to save & enter financial mainstream

Ex: \$325 payday loan  
(flipped the average 8 times)  
= \$468 total interest, or  
\$793 paid back

Ex: \$220 TV  
(78 payments of \$10)  
= \$560 total interest, or  
\$780 paid back



## Fringe & Predatory Services Continued:

- Pawnshops: borrow money secured by a valuable
- Check Casher: why do they exist?  
Charge 2% -4% of check. Free at a bank
- Tax preparation: refund anticipation loans, overestimated tax credits, free option (IRS VITA)



## Debt-to-income (DTI) Ratio:

- Measure of ratio of monthly debt payments to monthly income
- Used in lending decisions
- Several types:
  - Front end DTI – looks only at housing costs (rent or mortgage + taxes, insurance, interest, etc.)
  - Bank end DTI – looks at housing costs PLUS all other debt
- What the percentages mean:
  - Luis' back-end DTI =  $\$1,150$  (debt payments) +  $\$300$  (rent) /  $\$2,000$  (income): 72.5%
  - Luis spends  $\$350$ /month on rent so his front end ratio is  $\$300/\$2,000$  = 15%

# Debt Collection – Your Rights:

Debt collectors must follow certain rules:

- Only call Monday – Friday between 8 AM & 9 PM
- They may call family members or references you listed, but they must stop if asked
  - Cannot divulge information about the debt
- You have the right to ask the creditor to cease contacting you
- Collectors cannot harass or threaten you
- If your rights are violated, contact the FTC
- Debt collectors cannot garnish certain income:
  - Public assistance
  - Court-mandated compensation



**The End**