



By: Daron Arnold – Los Angeles, CA

The Bare Bones Of Loans: Lessons in borrowing basics

Loans can become a double-edged sword if they aren't handled wisely. In most situations they help businesses grow, aid in buying houses and cars, and allow for purchases that stimulate the economy, but taking on too much debt can have serious consequences. It's important to know what you're getting into, so let's take a glance at the two major types of loans:

Secured loans require collateral, like a car, to reduce the risk of lending money. If unable to make payments, you may have to forfeit the collateral to the lender.

Unsecured loans don't require collateral. The loan is supported by a strong credit history, rather than collateral.

Loan approval

Though they may have different loan-approval policies, all lenders view your credit report to help determine who you are as a potential borrower.

Credit scores range from 300 to 850. A score of 700 or above is good, but anything lower than 600 could appear too risky to lenders.

Before starting any loan process, check your credit report for errors at annualcreditreport.com. Common mistakes include:

- Misspelled personal information
- Outdated information
- Someone else's information
- Missing accounts
- Identity theft or fraud

Garnering interest

Like any other purchase, shop around to find the best deal. The difference between an 8% and a 12% interest rate can mean big bucks. Take for example a \$7,200 loan with a 5 year term:

	Interest Rate	Monthly Payment	Total Amount Paid
Loan A	8%	145.99	8,759.40
Loan B	10%	152.98	9,178.80
Loan C	12%	160.16	9,609.60

Although the interest rate is important when determining the value of a loan, there are other conditions to consider.

Don't forget to ask about:

- **Fixed or variable interest rate:** You'll want to know if the interest rate adjusts after a certain period of time, or stays consistent during the lifetime of the loan.
- **Payoff penalties:** Some lenders charge extra for paying off the loan early.
- **Closing costs:** Does finalizing the paperwork incur an additional charge?
- **Hidden costs:** Read the fine print, as some costs may not be apparent upfront.

The final countdown

Depending on the type of loan, the loan officer may require additional information during the application process. This is because the creditor not only examines your credit report, but also considers the five Cs of credit:

- **Character:** Who are you as a borrower?
- **Capacity:** Have you paid all your bills on time?
- **Capital:** What are your cash reserves and salary?
- **Collateral:** Do you have any assets to pledge toward your loan?
- **Current conditions:** What state is the market in? This is the only factor you have no control over.

If you are approved, the loan officer will outline the amount of money you're approved for, the interest rate, the repayment plan, and any other conditions for your particular loan. Read over the terms and conditions carefully. If you have any questions, ask them before you commit yourself to the loan. Never sign the final paperwork until you are completely satisfied.

Bottom line: In the U.S., a record 1.35 million homes were in foreclosure and 6.99% of mortgage borrowers were behind on payments, as of December 2008. It's important to understand the risk and know what you're getting yourself into when you apply for a loan.

Sources: investopedia.com; finance.yahoo.com; consumerfed.org; businessdictionary.com; money.cnn.com; fool.com; investorwords.com; moneychimp.com; nyc.gov

Stats

Over 1 million Americans seek the help of a credit counselor each year.

Source: investopedia.com

23.4%--the amount home prices had declined from mid-2006 to October 2008, according to the S&P's home-price index.

Sources: wsj.com; standardandpoors.com

Used with the permission of brass/MEDIA Inc.

brass|MEDIA Inc. licensed content is provided with the understanding that the publisher, copyright holder and organizations distributing the magazine are not rendering investment, financial or other professional advice. Investment and other financial decisions depend on each reader's individual facts and circumstances. You should not make decisions based on information contained in licensed brass content without the advice of a qualified professional.