

MODULE **5**

# Saving and borrowing

## Learning objectives

By the end of the session you will...

Understand the meaning and consequences of:

- Saving
- Borrowing

## Activity

- 5.1 *What, why and how do people save?*
- 5.2 *What, why and how do people borrow?*
- 5.3 *Differences between credit and loans.*
- 5.4 *When might you save or borrow?*

### 5.1 What is saving?

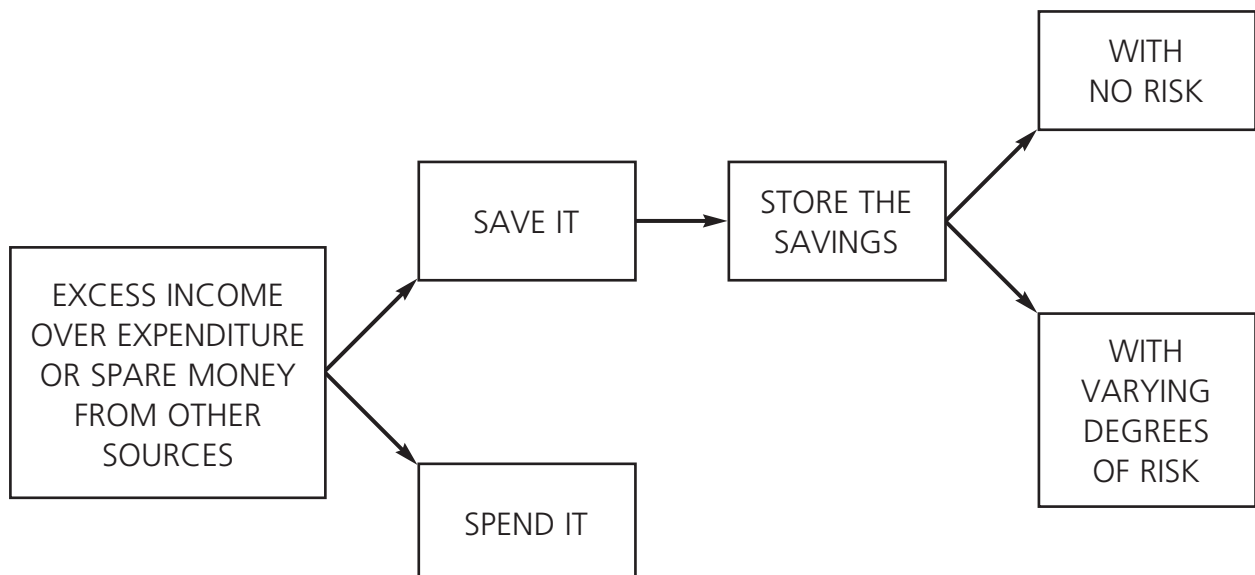
Saving begins by setting aside part of one's regular income for use in the future.

#### Why do people save?

The purpose is often to do one or more of these:

- i) Create an emergency fund for times of financial difficulty
- ii) Accumulate enough money for a special purchase, without borrowing
- iii) Cover the costs of a known or expected event, e.g. a wedding, a birth, a holiday
- iv) To enhance other financial provisions for retirement
- v) To create a sense of financial security and independence.

**Can you think of any other reasons to save?**



**How do people save?**

Some save regularly, either on a weekly or monthly basis, for others it is an occasional or infrequent action when spare funds become available such as a bonus or a gift.

Whilst savings can be kept in cash and stored at home – under the bed! – it is normal to find a means of ‘storing’ the savings. These means of storing savings fall into two broad categories:

- a) Those which keep the basic savings intact and add interest from time to time, for example bank deposits, building society savings accounts and the like. The level of interest payable may depend on the length of time that the saver is prepared to ‘lock’ away the savings.
- b) Those which don’t guarantee the core savings, but which give the prospect of higher returns, if the venture being invested in is successful, for example stocks and shares, property and the like.

The means chosen for ‘storing’ the savings should depend on the saver’s own objectives and needs. Some of the questions to be considered by any saver are:-

- a) Am I able to commit to regular saving out of my income or am I going to have varying amounts to save from time to time?
- b) Do I need to have immediate access to all or some of my savings, or can I ‘lock’ it away for some time?
- c) If I can ‘lock’ my savings away, when is the most likely date when I shall need access to them?
- d) What are the events in my life for which I am likely to need access to my savings?
- e) How much risk am I prepared to take with my savings in order to try to improve the returns I get? (See Module 7)
- f) Where can I get the advice and information I need to plan the protection and investment of my savings?

**5.2 What is borrowing?**

Borrowing involves obtaining money or goods from a third party, under an agreement to repay over a period or by the end of a period. Interest is normally charged which means one pays back more than the original amount borrowed.

**Why borrow?**

The purpose can be to:-

- a) Provide funds to deal with a financial emergency
- b) Enable the borrower to purchase something that would otherwise be outside their financial reach, e.g. a house
- c) Enable the borrower to purchase something immediately, rather than waiting to build up savings, e.g. car, furniture etc.

**How do people borrow money?**

The main methods of borrowing are:-

*A loan* – which means borrowing from an organisation such as a bank or building society and repaying with interest over an agreed period – normally 1 to 5 years.

*A mortgage* – which means borrowing from an organisation such as a bank or building society to purchase property, which is held by the lending institution as security. Repayment, with interest, is usually made over a longer period than other loans – typically 25 years.

*Credit* – which means obtaining goods and services immediately and paying for them later. Payment can be in instalments over a period – usually short – and be made either to the provider of the goods and services or to a third party, such as a credit card company.

It is usual for interest to be charged on borrowing (occasionally retailers will offer interest-free credit as part of a sales promotion). The level of interest will depend on:

*Whether there is security provided to the lender, e.g. a house in the case of a mortgage*

*The nature of the loan e.g. bank overdraft with fluctuating outstanding balance, fixed term loan with set regular repayments*

*The length of time over which the loan or credit will be repaid*

Failure to meet the repayment conditions of a loan or credit leads to additional interest charges and financial penalties, which can often be severe. In extreme cases, failure to repay in accordance with

the loan or credit agreement, can lead to repossession of the property or goods which were the subject of the borrowing.

Where an individual has several debts from different borrowers, professional help may be necessary to organise the repayments and prioritise the debt.

Some of the questions to be considered by a borrower are:-

a) Do I need to borrow this money or should I try to save for what I want to buy?

- b) What interest and other charges am I being asked to pay?
- c) How long do I have to repay the debt?
- d) What is the repayment schedule and can I afford the repayments?
- e) Is there a better way of borrowing?
- f) What will happen to my debt if I meet a temporary financial difficulty?
- g) Can I repay the debt earlier and if so, do I incur financial penalties?
- h) Does my past credit history make me a risk for which I shall have to pay higher charges?

**5.3 Credit and loans**

What is the difference between obtaining credit and obtaining a loan?

Credit is simply delaying payment for goods and services – but not for long otherwise it effectively becomes a loan. Interest is usually higher on credit than on arranged loans.

A loan is a planned borrowing of money to be repaid over a fixed period.

A loan can really be seen as managed debt.

<b>Consider whether you would save or borrow in the following circumstances.</b>		
	Save	Borrow
Buying a house		
Buying a car		
Paying for a holiday		
Meeting university costs		
Paying for a family event – wedding, christening, etc.		
Buying a computer, TV/video		
Repaying credit card debts		
Funding for retirement		
<b>Give reasons, briefly, for your decisions. Check your answers with those in section 5.4</b>		
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## 5.4 When might you save or borrow?

### Buying a House

Most people borrow money to buy a house. This is because it would take a great deal of time to save enough money and meanwhile you have to live somewhere. So usually borrowing is done through a mortgage.

Mortgages can be obtained from several sources including banks and building societies.

### Buying a Car

Either saving or borrowing is used to buy a car. If the car is not required immediately then saving is the preferred option since borrowing means that the car costs more because of the interest on the loan.

### Paying for a Holiday

A holiday is not an essential item of expenditure; it is a want rather than a need. People pay for holidays in a variety of ways:

*By saving for it*

*By credit using a credit card*

Long-term borrowing for a holiday increases the cost because of the interest paid.

### Meeting University Costs

These can be considerable and run to thousands of pounds. Some parents have saved over the long-term to pay for university fees. If this is not the case then fees are paid by borrowing money in the medium-term. Student loans have special features such as lower interest rates if they are paid back over a certain time period. The loan however does have to be repaid.

### Paying for a family event – e.g. wedding

This can also be a substantial cost. Many families have planned ahead and saved over the long-term. They may have locked their savings away because they knew they would not be needed for many years and so obtained a higher rate of interest. Since such a family event may be seen as very important it is unlikely that this would be saved in a way that was too risky.

### Buying a computer, TV, Video

In some cases a computer is essential and it would take too long to save for it. So the options are to obtain credit and repay quickly or else to take out a loan i.e. borrow money. The item then costs more because of the interest paid on the loan. If the purchase is not immediate then saving is a better option.

### Repaying Credit Card Debt

The credit card company usually requires you to pay at least 3% of the outstanding credit each month. Interest is payable on the outstanding balance. You should aim to pay it off at a faster rate because the interest rate is so high. The ideal is to pay off the whole amount at the end of the month to avoid interest charges altogether. Credit cards are not a good way of borrowing money except for the very short term. It will often be cheaper to arrange a bank loan to pay off the credit card debt.

### Funding for Retirement

Retirement funding is substantial and needs to be thought about sooner rather than later. It is necessary to save over a long time period in order to create enough money to fund retirement. There are various options which are considered in Module 8.