

# STAYING ON GOOD TERMS: CREDIT AND DEBT

## How Much Does That Latté Really Cost?

We all know that if you buy something with a credit card and don't pay the bill in full when it arrives, you're going to pay some interest. But have you ever thought about how much the item really costs when you allow interest to accrue? For example, if you pay for a daily latté with a credit card and don't pay the bill in full at the end of the month, what does that daily latté really cost you? The same principle applies if you pay for this or any other treat with money from your student loans.

### *An Illustration*

Suppose you buy a latté every weekday at a cost of \$3 each. The table at right illustrates the real cost of buying that daily latté if you used **Unsubsidized Federal Stafford Loan** funds to pay for it.

The important point to note is that the daily lattés in the illustration were bought with student loan funds. Whenever you buy something with student loans (or with any other form of credit), you are paying for that item with your future income. You're not using your own money now—you're using borrowed funds (i.e., someone else's money).

It isn't until you repay the debt that you pay for the item. And that payment will include not only the original cost but interest as well.

Will you be able to afford that payment? Would you rather have that money for something else once you graduate? These are questions to think about when you evaluate the real cost of that daily latté.

Daily Latté's Real Cost	2 Years in School	3 Years in School	4 Years in School
Daily cost	\$3	\$3	\$3
Number Purchased/Week	5	5	5
Total Cost/Week	\$15	\$15	\$15
Number of Weeks/Year	52	52	52
Total Cost (Principal)/Year	\$780	\$780	\$780
Total Cost (Principal) for ALL Years in School	\$1,560	\$2,340	\$3,120
Annual Interest Rate	8.25%	8.25%	8.25%
Repayment Term (# of months)	120	120	120
Total Interest You Will Pay	\$1,115	\$1,814	\$2,609
REAL COST—Total Principal & Interest You Will Pay	\$2,675	\$4,154	\$5,729

\* This estimate assumes that: (1) interest accrues on your loan during in-school and grace periods, (2) repayment begins following a 6-month grace period, (3) monthly payments are based on using an equal payment plan, and (4) accrued interest is capitalized once at the end of the grace period. The maximum interest rate allowed on Federal Stafford Loans of 8.25% is used here. Payment estimates were calculated using the "Interactive Calculators" available on the Access Group Web site at [accessgroup.org](http://accessgroup.org). All estimates are rounded to the nearest whole dollar.

Source: Access Group. 2002. How Much Does That Latté Really Cost?

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### How Much Do You Want To Pay For That Textbook?

**Another illustration:** Suppose you paid \$50 for a textbook and charged it to your credit card. The table below tells you how much that textbook would cost if you pay off the balance over time. If your interest rate is 19.8% and you take a year to pay off the balance, you'll pay \$60.85. \$11 isn't too bad for the privilege to "buy now, pay later." But what if you bought 5 \$50 textbooks? And if you take 20 years to pay off your credit card, that \$50 textbook would cost you over \$2,500. Obviously, no one plans to take 20 years (or even 5 years) to pay off a credit card but if you don't have a plan, it could happen.

Your \$50 textbook bought on a credit card and paid over time					
Finance Period	10.8%	13.8%	16.8%	19.8%	22.8%
1 year	\$55.68	\$57.35	\$59.08	\$60.85	\$62.67
4 years	\$76.87	\$86.56	\$97.45	\$109.68	\$123.41
5 years	\$85.59	\$99.29	\$155.15	\$133.48	\$154.68
10 years	\$146.53	\$197.19	\$265.17	\$356.34	\$478.49
15 years	\$250.83	\$391.59	\$610.66	\$951.26	\$1,480.21
20 years	\$429.39	\$777.65	\$1,406.31	\$2,539.46	\$4,579.04

Source: Kentucky Higher Education Assistance Authority. It's Money, Baby!