

Personal Finance, 6e (Madura)
Chapter 9 Personal Loans

9.1 Background on Personal Loans

1) A personal loan is different from a credit card in that it is normally used to finance one large purchase.

Answer: TRUE

Diff: 1

Question Status: Previous edition

2) The most common source of financing for a personal loan is from a financial institution.

Answer: TRUE

Diff: 1

Question Status: Previous edition

3) In securing personal loans from family members or friends, the loan agreement should be verbal or just consist of a "gentlemen's understanding."

Answer: FALSE

Diff: 1

Question Status: Revised

4) When borrowing money from a family member or a friend, the loan agreement should be in writing and signed by all parties to avoid any possible misinterpretations.

Answer: TRUE

Diff: 1

Question Status: Previous edition

5) When applying for a personal loan, you will be required to fill out a loan application but you will seldom need a personal balance sheet or a personal cash flow statement.

Answer: FALSE

Diff: 2

Question Status: Previous edition

6) In determining the amount of your loan, you should ask for about 20% more than you need in order to give yourself financial flexibility in the future.

Answer: FALSE

Diff: 2

Question Status: Previous edition

7) On an amortization schedule, more interest and less principal is paid each month as the loan matures.

Answer: FALSE

Diff: 2

Question Status: Previous edition

8) Longer maturities for loans result in lower monthly payments and therefore make it easier to cover payments each month.

Answer: TRUE

Diff: 1

Question Status: Previous edition

9) Collateral is defined as assets of the lender that back a secured loan in the event of default.

Answer: FALSE

Diff: 2

Question Status: Previous edition

10) In general, you will receive more favorable terms on a secured loan than on an unsecured loan.

Answer: TRUE

Diff: 2

Question Status: Previous edition

11) If a loan is cosigned and the borrower defaults, the lender has the right to sue the cosigner or try to seize the cosigner's assets just as if that person were the borrower.

Answer: TRUE

Diff: 1

Question Status: Revised

12) The monthly payment for a loan is dependent only on the size of the loan and the interest rate.

Answer: FALSE

Diff: 2

Question Status: Previous edition

13) Even an unsecured personal loan should be backed by collateral.

Answer: FALSE

Diff: 1

Question Status: Previous edition

14) A personal loan is different from a credit card in all of the following **except** it

A) is normally used to finance one large purchase.

B) has a specific repayment schedule.

C) can be used only once.

D) has a longer grace period.

Answer: D

Diff: 1

Question Status: Revised

15) For which of the following items would a personal loan be a better option than a credit card for a college student?

- A) Car maintenance expense
- B) Tuition and dorm fees
- C) Trips home for the holidays
- D) Tickets to sporting events

Answer: B

Diff: 2

Question Status: Revised

16) Which of the following is the most common source of financing for personal loans?

- A) Family and friends
- B) Financial institutions
- C) Peer-to-peer lending
- D) Sales finance companies

Answer: B

Diff: 2

Question Status: Revised

17) All of the following provide personal loans **except**

- A) commercial banks.
- B) insurance companies.
- C) finance companies.
- D) credit unions.

Answer: B

Diff: 1

Question Status: Revised

18) Personal loans include all of the following, **except**

- A) car loans.
- B) mortgage loans.
- C) student loans.
- D) home equity loans.

Answer: B

Diff: 2

Question Status: Previous edition

19) Personal loans include which of the following?

- A) Car loans
- B) Credit card advance payments
- C) Home equity loans
- D) Both A and C are correct

Answer: D

Diff: 1

Question Status: Previous edition

- 20) Personal loans from family members or friends
- A) are not good sources of financing.
 - B) are more expensive than loans from other sources.
 - C) should have a loan agreement in writing to avoid problems later on.
 - D) are not desirable from the lender's point of view.

Answer: C

Diff: 1

Question Status: Previous edition

- 21) The personal loan process with a financial institution requires all of the following **except**

- A) filling out an application.
- B) sitting through an interview.
- C) negotiating the loan contract.
- D) negotiating the interest rate.

Answer: B

Diff: 2

Question Status: Previous edition

- 22) Which of the following would probably **not** be required when applying for a personal loan?

- A) A personal résumé
- B) A personal balance sheet
- C) A personal cash flow statement
- D) A loan application

Answer: A

Diff: 1

Question Status: Previous edition

- 23) Which of the following items must you provide when applying for a loan in order to prove you have collateral to back your loan?

- A) Personal cash flow statement
- B) Paycheck stub
- C) Personal balance sheet
- D) Credit card statements

Answer: C

Diff: 1

Question Status: Previous edition

- 24) The document that specifies the term of the loan as agreed to by the borrower and lender is called the

- A) loan repayment schedule.
- B) loan contract.
- C) loan application.
- D) terms of agreement.

Answer: B

Diff: 1

Question Status: Previous edition

25) Which of the following is not included in the loan contract?

- A) Credit score
- B) Amount of the loan
- C) Interest rate
- D) Loan repayment schedule

Answer: A

Diff: 1

Question Status: Revised

26) The loan contract identifies all of the following **except**

- A) loan officer.
- B) maturity.
- C) loan repayment schedule.
- D) collateral.

Answer: A

Diff: 2

Question Status: Previous edition

27) The size of the monthly payment on a loan is dependent on all of the following **except**

- A) principal borrowed.
- B) interest rate.
- C) the borrower's age.
- D) maturity.

Answer: C

Diff: 1

Question Status: Revised

28) Regarding the amount of money borrowed on a loan, all of the following are true **except**

- A) the amount is based on how much the lender believes you can pay back in the future.
- B) you should borrow slightly more than you need to cover future inflation.
- C) you should only borrow the amount you need.
- D) you will have to pay interest on the entire amount.

Answer: B

Diff: 1

Question Status: Previous edition

29) In a loan repayment schedule, the term *amortized* refers to

- A) the method by which interest is calculated.
- B) the repayment of the principal and interest through a series of equal payments.
- C) the life of the loan.
- D) assets used to back the loan.

Answer: B

Diff: 2

Question Status: Previous edition

30) The _____ the maturity of a loan, the _____ the payments.

- A) longer; smaller
- B) shorter; larger
- C) shorter; smaller
- D) Both A and B are correct

Answer: D

Diff: 2

Question Status: Previous edition

31) What is the correct chronological order of the items listed below?

- A) Good credit history, loan contract, repayment schedule, loan application
- B) Good credit history, loan application, loan contract, repayment schedule
- C) Good credit history, repayment schedule, loan application, loan contract
- D) Good credit history, repayment schedule, loan contract, loan application

Answer: B

Diff: 3

Question Status: Previous edition

32) Making extra payments on a loan does all of the following **except**

- A) reduces the total amount of interest paid.
- B) gives you extra income for living expenses.
- C) reduces the maturity of the loan.
- D) helps assure your good credit rating.

Answer: B

Diff: 2

Question Status: Revised

33) Over the life of a loan, the payment to principal _____ and the portion to interest expense _____.

- A) increases; increases
- B) decreases; increases
- C) increases; decreases
- D) decreases; decreases

Answer: C

Diff: 2

Question Status: Previous edition

34) Having a longer term loan

- A) costs you more interest and therefore increases the cost of your loan.
- B) makes your monthly payments larger.
- C) is almost always the best alternative for credit users.
- D) gives you access to additional sources of financing.

Answer: A

Diff: 1

Question Status: Previous edition

- 35) You could reduce the size of your monthly payments by
- A) agreeing to a higher interest rate.
 - B) borrowing the same amount of money but for a shorter period of time.
 - C) borrowing more money initially for the same period of time.
 - D) lengthening the maturity of the loan.

Answer: D

Diff: 2

Question Status: Previous edition

- 36) Which of the following is **not** usually used as collateral for a loan?

- A) A boat
- B) Clothing
- C) A car
- D) A house

Answer: B

Diff: 1

Question Status: Previous edition

- 37) Collateral

- A) gives the lender additional recourse if the payments are not made.
- B) is used on unsecured loans.
- C) increases the interest rate on loans.
- D) is required on all loans.

Answer: A

Diff: 1

Question Status: Previous edition

- 38) If you agree to allow the lender to take your computer in the event you fail to make payments, the loan is which of the following?

- A) Amortized
- B) Unsecured
- C) Secured
- D) Interest free

Answer: C

Diff: 1

Question Status: Previous edition

- 39) Which kind of loan generally charges the lowest interest rate?

- A) Unsecured loan
- B) Secured loan
- C) Cash advance
- D) Vacation loan

Answer: B

Diff: 2

Question Status: Revised

- 40) All of the following are true regarding a cosigner on an account **except**
- A) the cosigner is responsible for any unpaid balance.
 - B) the lender may not seize the assets of the cosigner.
 - C) cosigning an account is a big liability and should be taken seriously.
 - D) cosigning on a loan can restrict the amount that the cosigner is able to borrow.

Answer: B

Diff: 2

Question Status: Previous edition

- 41) Common practices used by dishonest lenders include all of the following **except** the lender
- A) prohibiting the borrower from purchasing insurance or other financial services as a condition of the loan.
 - B) charging high loan fees which cause financing costs to be much higher than the quoted rates.
 - C) requiring that the borrower purchase insurance or other financial services.
 - D) requiring a large balloon payment that will necessitate additional financing to pay it off.

Answer: A

Diff: 1

Question Status: Revised

- 42) When the borrower and the lender have agreed to the specific terms of the loan these will be included in the _____.

Answer: loan contract

Diff: 1

Question Status: Previous edition

- 43) If the lender has the right to take certain specified assets of the borrower in the event of a default on the loan, the loan is a(n) _____ loan.

Answer: secured

Diff: 1

Question Status: Previous edition

Use the following two columns of items to answer the matching questions below:

- A) a contract that specifies the terms of the loan agreed to by the borrower and lender
- B) disclosure of information including a balance sheet and cash flow statement
- C) life or duration of a loan
- D) loan that is not backed by collateral

44) loan contract

Diff: 1

Question Status: New

45) maturity

Diff: 1

Question Status: New

46) loan application

Diff: 1

Question Status: New

47) unsecured loan

Diff: 1

Question Status: New

Answers: 44) A 45) C 46) B 47) D

48) List four components of a loan contract

Answer: Amount of loan, interest rate, loan repayment schedule, length of loan, collateral. There may be other acceptable answers in addition to the above.

Diff: 1

Question Status: Previous edition

49) All of the following are true of peer-to-peer lending, **except**

- A) it involves online platforms.
- B) borrowers generally have high FICO scores.
- C) loans are available only for amounts less than \$1,000.
- D) interest rates may be lower than at financial institution.

Answer: C

Diff: 1

Question Status: New

50) You could reduce the interest rate you are paying on loans by

- A) refinancing to a secured loan.
- B) paying off credit card debt with a home equity loan.
- C) refinancing to a shorter term loan.
- D) A, B, and C are all viable possibilities

Answer: D

Diff: 2

Question Status: New

51) If you double the principal repayment called for on your car loan each month without doubling the interest payment, you will

- A) reduce the term of the loan by half.
- B) reduce the amount of interest you pay by about 30%.
- C) not have much effect since you are not also doubling the interest paid monthly.
- D) Both A and B are correct.

Answer: A

Diff: 3

Question Status: New

9.2 Interest Rates on Personal Loans

1) If the interest rates are the same, a loan using add-on interest will have higher payments and charges than a loan using simple interest.

Answer: TRUE

Diff: 2

Question Status: Previous edition

2) The Truth-in-Lending Act (1969) requires which of the following?

- A) Adherence to the interest rates established by the Federal Reserve
- B) Specifying loan rate standardization
- C) Disclosure of only interest charges but no other fee
- D) All of the above

Answer: B

Diff: 2

Question Status: Previous edition

3) Which of the following is **not** an interest rate calculation method discussed in the text?

- A) Annual percentage rate or APR
- B) Sum of the digits interest
- C) Simple interest
- D) Add-on interest

Answer: B

Diff: 2

Question Status: Previous edition

4) The APR measures the finance expenses (including interest and all other expenses) on a loan on a(n)

- A) quarterly basis.
- B) annualized basis.
- C) monthly basis.
- D) daily basis.

Answer: B

Diff: 1

Question Status: Previous edition

5) Which of the following methods of calculating interest is the most expensive?

- A) Annual percentage rate or APR
- B) Simple interest
- C) Add-on interest
- D) Sum of the digits

Answer: C

Diff: 2

Question Status: Previous edition

6) The method of determining the monthly interest amount by adding the interest and loan principal together and dividing by the number of payments is the

- A) simple-interest method.
- B) annual percentage method.
- C) simple-interest declining balance method.
- D) add-on interest method.

Answer: D

Diff: 1

Question Status: Previous edition

7) You obtain a loan of \$3,000 based on simple interest with an annual interest rate of 12%. At the end of the first month, the interest owed on \$3,000 is

- A) \$30.
- B) \$36.
- C) \$300.
- D) \$360.

Answer: A

Explanation: A) $(\$3,000 \times 0.12)/12 = \30

Diff: 2

Question Status: Revised

8) You obtain a loan of \$3,000 based on simple interest with an annual interest rate of 12%, or 1% a month. If the first payment is \$300, how much is the principal portion of the payment?

- A) \$27
- B) \$270
- C) \$280
- D) \$295

Answer: B

Explanation: B) $\$300 - (\$3,000 \times 0.01) = \$270$

Diff: 2

Question Status: Revised

9) You obtain a loan of \$3,000 to be repaid over one year. Assume you are charged 12% interest based on the add-on method. Your monthly payments would be

- A) \$280.
- B) \$300.
- C) \$360.
- D) \$270.

Answer: A

Explanation: A) $\$3,000 \times .12 = \360 ; $\$3,000 + \$360 = \$3,360$; $\$3,360/12 = \280

Diff: 2

Question Status: Revised

10) _____ is a method of computing interest based on the existing principal amount of the loan.

Answer: Simple interest

Diff: 1

Question Status: Previous edition

Use the following two columns of items to answer the matching questions below:

- A) assets of a borrower that back a secured loan
- B) interest rate multiplied by the principal
- C) rate that measures the finance expenses

11) APR

Diff: 1

Question Status: New

12) simple interest

Diff: 1

Question Status: New

13) collateral

Diff: 1

Question Status: New

Answers: 11) C 12) B 13) A

14) What does the Truth-in-Lending Act of 1969 require lenders to do? What is the APR, and how does it fulfill the purpose of the Act?

Answer: Lenders are required to disclose a standardized loan rate with directly comparable interest expenses over the life of the loan. This standardized rate is the APR (annual percentage rate) which measures the finance expenses (including interest and all other expenses) on a loan annually. The APR makes it easier for individuals to compare loans offered by different lenders and select the best loan.

Diff: 1

Question Status: Revised

15) Lucky Louie applied for a \$5,000 loan payable in one year and was provided the following data; interest due at payoff of \$750, application fee \$100, credit check \$75, processing fee \$75. What is the APR of Louie's loan?

- A) 20%
- B) 17.5%
- C) 22.5%
- D) There is not enough information to determine the answer.

Answer: A

Diff: 2

Question Status: New

9.3 Car Loans

1) Buying a car from a dealer with a set price (a no haggle dealer) is usually more stress-free and less time consuming.

Answer: TRUE

Diff: 1

Question Status: Previous edition

2) Buying a new car online is just about as efficient as buying an airline ticket or a book.

Answer: FALSE

Diff: 2

Question Status: Previous edition

3) It is important to buy a car that is not over your budget and to finance the car properly. The more money needed to cover the car payments, the less you can add to your savings or other investments.

Answer: TRUE

Diff: 1

Question Status: Previous edition

4) Auto loan Internet sites are a good source to estimate the maximum amount you can borrow, based on financial information you provide.

Answer: TRUE

Diff: 1

Question Status: Previous edition

5) Shopping for automobile insurance should begin immediately after you close the deal on the car.

Answer: FALSE

Diff: 1

Question Status: Previous edition

6) What should you not consider when selecting a vehicle?

A) Personal preferences

B) Insurance costs

C) All parts are American-made

D) Resale value

Answer: C

Diff: 1

Question Status: Previous edition

7) Considerations in selecting a car should include all of the following **except**

- A) what kind of car you really want, regardless of what you need.
- B) the size of the car.
- C) the price of the car.
- D) the size of the engine and fuel economy.

Answer: A

Diff: 1

Question Status: Revised

8) Regarding automobile insurance,

- A) the best time to shop for rates is while you are at the car dealership.
- B) most cars cost the same to insure if the driver is the same.
- C) it is better to compare costs before you commit to buying a particular car.
- D) you can lower your costs by buying a more expensive car that is less likely to have accidents.

Answer: C

Diff: 1

Question Status: Previous edition

9) Automobile insurance rates are likely to differ for all of the following reasons **except** some cars

- A) are more popular than others.
- B) cost more to repair after accidents.
- C) are more common theft targets.
- D) are higher priced.

Answer: A

Diff: 1

Question Status: Previous edition

10) Which is true regarding resale value of cars?

- A) You can't really determine the resale value very accurately before you buy a car.
- B) You are always better off to buy a higher priced car with a greater resale value.
- C) You are always better off to buy a lower priced car with a lower resale value.
- D) Resale values can be determined from the Internet and other sources and should be a consideration in buying a car.

Answer: D

Diff: 1

Question Status: Previous edition

11) In the past you have purchased cars that you have driven for 10 years or more. The mileage on these vehicles usually exceeded 100,000 and therefore you would just give them to a younger family member. Based on this history, your **primary** financial consideration in selecting a car will be

- A) resale value.
- B) financing rate.
- C) repair expense.
- D) personal preference.

Answer: C

Diff: 2

Question Status: Revised

12) Purchasing a car is a big decision. Therefore you should **not**

- A) use the Internet to price shop.
- B) read Consumer Reports to find a good car value.
- C) ask a friend or relative to go with you to the car lot.
- D) rely on the dealer personnel as the best source of expert advice.

Answer: D

Diff: 1

Question Status: Previous edition

13) When considering how much money to spend on the purchase of a new car, you must consider how your choices affect your spending on other needs. The _____ solution limits your credit card purchases to what you can afford to pay off when your credit card bill arrives each month.

- A) maximum debt
- B) limited debt
- C) no debt
- D) minimum debt

Answer: B

Diff: 1

Question Status: Revised

14) The more expensive the car, the _____ the payments, and the _____ you can put toward other investments.

- A) higher; more
- B) higher; less
- C) lower; less
- D) lower; more

Answer: B

Diff: 1

Question Status: Previous edition

- 15) The most favorable car financing is that of
- A) commercial banks.
 - B) credit unions.
 - C) car dealers.
 - D) There is no one best deal every time; it pays to shop around.

Answer: D

Diff: 1

Question Status: Previous edition

- 16) The advantage to financing a car for a long period of time (of up to seven years) is
- A) you will build equity in the car faster.
 - B) the car will be worth more by the time you pay off the loan.
 - C) your monthly payment will be lower.
 - D) you will be able to sell the car before you pay off the loan and have money to pocket.

Answer: C

Diff: 3

Question Status: Previous edition

- 17) If you are considering trading in a used car when you purchase your new one, it is best to
- A) tell the dealer right away so that your trade-in credit can be calculated against the purchase of your new car.
 - B) not trade the car in, but rather sell it yourself to someone else.
 - C) make the trade-in deal a separate transaction from the new car deal.
 - D) not be too concerned about the value given, since dealers are required to give you at least blue book value.

Answer: C

Diff: 1

Question Status: Revised

- 18) When assessing the condition of a used car, you should carefully consider all of the following **except**
- A) the condition of the interior.
 - B) the insurance premium the previous owner paid.
 - C) the condition of the exterior.
 - D) the history of routine maintenance.

Answer: B

Diff: 1

Question Status: Previous edition

- 19) When negotiating the price of any car, which of the following statements is true?
- A) The car dealer earns a small profit if the customer doesn't negotiate and pays full price.
 - B) Dealers that negotiate will purposely price cars below the price for which they are willing to sell the car.
 - C) Sales people are trained to act as if they are giving the car away.
 - D) Salespeople are uncertain of the price at which they can sell you the car until you begin negotiations.

Answer: C

Diff: 1

Question Status: Revised

20) When deciding whether to trade in a car or sell it privately, which of the following is not a consideration?

- A) "ACV" or actual cash value being offered by the dealer
- B) Private sale price you think you can achieve if you sell the car yourself
- C) Sales tax offset for the trade-in offered by many states
- D) Year, make and model of the car

Answer: D

Diff: 2

Question Status: New

9.4 Purchase Versus Lease Decision

1) Advantages to leasing a car instead of buying one are that you need less of a down payment and that you do not need to worry about finding a buyer for your car when the lease is over.

Answer: TRUE

Diff: 1

Question Status: Previous edition

2) It is usually better to lease a vehicle than buy one, since you are not responsible for the repairs or maintenance on a leased car.

Answer: FALSE

Diff: 2

Question Status: Previous edition

3) Leasing a car is a good option if you drive many miles a year.

Answer: FALSE

Diff: 1

Question Status: Previous edition

4) The decision to purchase versus lease a car is highly dependent on the estimated market value of the car at the end of the lease period.

Answer: TRUE

Diff: 2

Question Status: Previous edition

- 5) In which of the following scenarios would you favor leasing over purchasing a car?
- A) The number of miles that you drive each year varies significantly and is hard to predict.
 - B) Repair expenses on the car are very low.
 - C) The car in question is one whose value depreciates rapidly.
 - D) All of the above

Answer: C

Diff: 2

Question Status: Revised

- 6) If you always drive cars many miles and keep them for 10 years, it would probably be best to
- A) lease a new car.
 - B) lease a used car.
 - C) buy a new car.
 - D) buy a used car.

Answer: C

Diff: 2

Question Status: Previous edition

- 7) The cost of leasing a car versus purchasing one
- A) is more.
 - B) is less.
 - C) is about the same.
 - D) varies depending on a multitude of factors.

Answer: D

Diff: 2

Question Status: Previous edition

- 8) In making the purchase versus leasing decision, it is important to remember that
- A) dealers may impose an additional mileage cost.
 - B) leasing is less risky than a purchase.
 - C) leasing is less expensive than a purchase.
 - D) you won't be required to pay maintenance costs on the leased car.

Answer: A

Diff: 1

Question Status: Previous edition

- 9) Advantages of leasing a vehicle include all of the following **except**
- A) no substantial down payment.
 - B) don't have to worry about resale of the car when you are finished with it.
 - C) less hassle than purchasing a vehicle.
 - D) no maintenance costs.

Answer: D

Diff: 1

Question Status: Previous edition

10) Disadvantages of leasing a vehicle include all of the following **except**

- A) no equity in the car.
- B) cost of finding a buyer for the car at the termination of the lease.
- C) responsibility for maintenance costs.
- D) additional charges beyond the monthly lease payments.

Answer: B

Diff: 1

Question Status: Previous edition

11) What would be the total cost of leasing a vehicle for four years that requires a security deposit of \$1,000 (which would be withdrawn from your portfolio, which earns 9% per year), has monthly lease payments of \$500, and has a mileage restriction of 20,000 with excess mileage resulting in a 10 cents per mile charge. Assume that over the life of the lease you exceed the mileage limitations by a total of 8,000 miles.

- A) \$24,000
- B) \$24,360
- C) \$24,800
- D) \$25,160

Answer: D

Explanation: D)

Lease payment $\$500 \times 48$ months	\$24,000
Opportunity cost ($\$1,000 \times 0.09$) 4 years	\$360
Mileage overage $8,000 \times 10$ cents	<u>\$800</u>
	\$25,160

Diff: 2

Question Status: Revised

12) What is the total cost of leasing a vehicle for three years that requires a security deposit of \$300 (would earn 3% interest in a money market account otherwise), has monthly lease payments of \$385, and has a mileage restriction of 10,000 with excess mileage resulting in a 10 cents per mile charge. Assume that over the life of the lease you exceed this limitation by 8,000 miles.

- A) \$14,160
- B) \$13,860
- C) \$14,687
- D) \$14,660

Answer: C

Explanation: C)

Lease payments $\$385 \times 36$ months	\$13,860
Opportunity cost ($\$300 \times .03$) $\times 3$ years	\$27
Mileage overage $8,000 \times 10$ cents	<u>\$800</u>
	\$14,687

Diff: 2

Question Status: Revised

13) Which of the following is a key benefit of leasing?

- A) You do not have to fill out a credit application.
- B) You do not have to maintain the car since you do not own it.
- C) You are able to drive a more expensive car for the same monthly payment versus buying.
- D) A, B and C are all correct.

Answer: C

Diff: 2

Question Status: New

14) Which of the following are important factors in determining the monthly lease price of a new car?

- A) Purchase price or capitalized value
- B) "Money factor" or interest rate embedded in the lease
- C) Residual value of the car included in the lease contract
- D) A, B and C are all key factors in determining the monthly lease payment

Answer: D

Diff: 2

Question Status: New

9.5 Student Loans

1) Because interest is usually tax deductible and payments are deferred until you graduate, it is good advice to take out the maximum student loan for which you can qualify.

Answer: FALSE

Diff: 2

Question Status: Revised

2) There are limits on how much a student can borrow through federal student loans, so many students also have to obtain private loans from financial institutions.

Answer: TRUE

Diff: 2

Question Status: Revised

3) Which of the following is a true statement about student loans?

- A) All student loans are provided by the U.S. government.
- B) All student loans have fixed interest rates.
- C) Interest payments on some loans are deferred until the students graduate and enter the workforce.
- D) Interest is tax deductible for those at all income levels.

Answer: C

Diff: 1

Question Status: Revised

4) Which of the following statements about student loans is **not** true?

- A) If you don't complete your education, you will not have to pay back your student loan.
- B) A school's financial aid office is a good source of information on student loans.
- C) Both the federal government and financial institutions participate in the student loan program.
- D) Interest is often deferred and there can be tax savings on the interest paid on student loans.

Answer: A

Diff: 1

Question Status: Revised

5) A loan provided to finance the expenses of a person pursuing a college degree is called a(n)

_____.
Answer: student loan

Diff: 1

Question Status: Previous edition

6) List the advantages and disadvantages of paying for your education with student loans.

Answer: Advantages—pay later with no interest in some cases, until you get out of school. You will have more funds from employment to pay a loan later. Disadvantages—interest is the cost of borrowing the money and thus the education costs more. It is difficult to pay back a student loan on top of a mortgage and car payments when you have a family.

Diff: 1

Question Status: Revised

7) Since all student loans are not issued at the same interest rate over the course of a student's education year, once the student graduates and begins working and is starting to pay back the loans they should

- A) defer payment as long as possible.
- B) make only the minimum payments.
- C) prioritize the loans from highest interest rate to lowest interest rate and use excess cash flow to make additional payments on the high rate loans.
- D) pay all loans at an equal pace since they all count in your credit score.

Answer: C

Diff: 2

Question Status: New

9.6 Home Equity Loan

1) The proceeds from a home equity loan can be used for any purpose including a vacation, tuition payments, or health care expenses.

Answer: TRUE

Diff: 2

Question Status: Previous edition

2) Even though you don't use the proceeds to improve your home, the interest on a home equity loan is deductible for federal income tax purposes.

Answer: TRUE

Diff: 1

Question Status: Revised

3) Home equity is defined as the market value of the home less the debt owed on the home.

Answer: TRUE

Diff: 1

Question Status: Previous edition

4) Financial institutions provide home equity loans up to a maximum of 70% of the value of the equity in a home.

Answer: FALSE

Diff: 2

Question Status: Previous edition

5) Because the market value of homes may decline, lenders do not like to lend the full amount of the equity when extending a home equity loan.

Answer: TRUE

Diff: 2

Question Status: Previous edition

6) All of the following are true of a home equity loan **except** it

A) provides you with a line of credit or a lump sum of money, depending on the type of loan.

B) is a good way to combine different kinds of debt.

C) may be tax deductible.

D) allows you to borrow up to 20% of the market value of your home.

Answer: D

Diff: 1

Question Status: Revised

7) Financial institutions typically provide home equity loans up to _____ of the value of the equity in a home.

- A) 98%
- B) 80%
- C) 70%
- D) 45%

Answer: B

Diff: 2

Question Status: Revised

8) You have a home with a market value of \$200,000. Your total equity in the home is \$40,000. The maximum home equity loan available if the bank will loan 80% based on equity invested is

- A) \$28,000.
- B) \$32,000.
- C) \$112,000.
- D) \$128,000.

Answer: B

Explanation: B) $\$40,000 \times 0.8 = \$32,000$

Diff: 2

Question Status: Previous edition

9) Frank purchased his home in 1997 for \$130,000. He added an addition costing \$35,000. The current tax assessed value is \$80,000 while the current market value is \$185,000. If Frank's current mortgage balance is \$95,000, his equity in his home is

- A) \$130,000.
- B) \$165,000.
- C) \$90,000.
- D) \$70,000.

Answer: C

Explanation: C) $\$185,000 - \$95,000 = \$90,000$

Diff: 2

Question Status: Previous edition

10) A few years ago Mary purchased a home for \$100,000. Today the home is worth \$150,000. The remaining balance on the mortgage is \$50,000. If Mary can borrow up to 80% of the market value of the equity, the maximum amount she can borrow is

- A) \$80,000.
- B) \$70,000.
- C) \$100,000.
- D) \$50,000.

Answer: A

Explanation: A) $\$150,000 - \$50,000 = \$100,000 \times 80\% = \$80,000$

Diff: 2

Question Status: Previous edition

11) If you borrow an \$8,000, 6.75% home equity loan, what is your tax savings for one year assuming your marginal income tax rate is 15%?

- A) \$540
- B) \$81
- C) \$270
- D) \$162

Answer: B

Explanation: B) $\$8,000 \times 6.75\% = \$540 \times 15\% = \$81$

Diff: 2

Question Status: Previous edition

12) A loan based on the difference between the appraised value of your house and the balance due on your mortgage is called a(n) _____ loan.

Answer: home equity

Diff: 1

Question Status: Previous edition

13) All of the following cash needs are appropriately sourced from a home equity loan versus credit card or short term personal loan, except for

- A) renovating your home.
- B) buying a new car which you plan to keep for 10 years.
- C) going to Disneyworld with your family.
- D) A,B and C are all correct.

Answer: C

Diff: 2

Question Status: New

9.7 Payday Loans

1) A payday loan is a short-term loan provided to you if you need funds in advance of receiving your paycheck.

Answer: TRUE

Diff: 1

Question Status: Previous edition

2) The cost of financing with a payday loan is more reasonable than the cost of obtaining credit through a credit card.

Answer: FALSE

Diff: 1

Question Status: Previous edition

3) One alternative to payday loans is to avoid borrowing until you have the funds to spend.

Answer: TRUE

Diff: 1

Question Status: Previous edition

4) All of the following are reasons to avoid payday loans **except**

- A) the cost of financing with a payday loan is exorbitant.
- B) you don't want to pay interest on your credit card that charges an annual rate of 18%.
- C) you may still not have sufficient cash after covering the loan.
- D) the use of payday loans can create a continual cycle of borrowing.

Answer: B

Diff: 1

Question Status: Previous edition

5) Rick needs an advance on his \$600 bi-weekly paycheck. He goes to Cash King where he writes them a check for \$690 and dates the check two weeks from today. The cost of financing Rick's payday loan is

- A) 391%.
- B) 521%.
- C) 261%.
- D) 547%.

Answer: A

Explanation: A) $\$90/\$600 = 15\%$; $15\% \times (365/14) = 3.91$ or 391%

Diff: 2

Question Status: Previous edition

9.8 How Personal Loans Fit Within Your Financial Plan

1) Determining the amount of money you can afford to borrow on a personal loan is a decision that should be included in your personal financial plan.

Answer: TRUE

Diff: 1

Question Status: Previous edition

2) Describe how personal loans affect your personal budget, income statement, and balance sheet. Has credit allowed you to expand your purchases?

Answer: This is a basic subjective answer. Interest expense on credit reduces wealth. However, purchases on credit allow you to purchase more assets. Loans are easy to obtain when collateral is available. Additional purchases need to be in the budget.

Diff: 1

Question Status: Previous edition