

Financial Literacy with Mr. 401(k) Winter Term 2024 - 2025 January 22, 2025

Owning & Owing Stuff Class 15: Liabilities – Understanding and Managing What You Owe



Recap: Important Financial Terms





Income

Making Money



Assets

The Stuff You <u>Own</u>



Expenses

Spending Money



Profit (Loss)

= Income - Expenses



Liabilities

The Stuff You Owe



Equity

= Assets - Liabilities



Anything you owe that has value

Liability

Anyone Can Owe Liabilities







Corporations

Governments

People

Interest the cost of borrowing or the reward for saving





If Borrowing...

The extra amount you pay to a person or company that let you borrow their money.

If Saving or Investing...

The extra amount you receive for letting someone else use your money.



Class Discussion

What are some examples of liabilities that people might owe? Why might people borrow money?

Liability Examples Teens May Experience



Allowance Advances

Money borrowed from parents in advance of a scheduled allowance Sports Club Dues

Outstanding dues or fees for club sports Library Fines

Fines on overdue library books Payment Plans

Payment plans to finance purchases over longer periods



Personal Loans

Money borrowed from friends or family for small purchases



Liability Classification





Current Liability

Liabilities due within one year. Something you expect to pay-off soon, like a cell phone bill.

Long-Term Liability

Liabilities due later than one year. Something you expect to pay-off over a long time, like a car loan.

Money Mavericks

Objective: Work to correctly identify the asset type and the asset classification withing your workgroups on the following Practical Applications slide.

Alpha: Green Beta: Orange Gamma: Gold



Practical Application

Within your Money Mavericks Workgroups, identify the Liability Classification as a Current Liability or a Long-Term Liability.



Debt Service

The money you need to pay **regularly** to fully repay a loan.

Example: A person borrows \$50 from a friend. The borrower agrees to repay the friend \$5 per week for 11-weeks until the debt is repaid with interest.

How much is the debt service?



Servicing debt requires cashflow greater than the debt service payment amount



Class Discussion

If you owe a friend \$50 but don't have a job, how could you pay back the loan?

Generating Cash to Pay Debt





Make More Money Increase Your Income Spend Less Money Decrease Your Expenses Sell Stuff You Own Sell Your Assets for Cash



Borrow More Money Increase What You Owe



Class Discussion

What are some problems with selling stuff you own or borrowing more money to repay debts?



Eventually, you run out of stuff to sell, and you run out of people who will lend you money.



Class Discussion

What do you think might happen if you don't have enough cash to service debts?



Class Discussion

What are some ways to avoid borrowing more money than you can handle?



Generally, when you pay back a loan, the first part of your payment covers interest (the cost of borrowing money). The rest goes toward reducing the amount you owe.

- Home Purchase
 - \$500,000 purchase price
 - \$100,000 down payment
 - Mortgage Amount = ?



- Home Purchase
 - \$500,000 purchase price

Any

Guesses?

- \$100,000 down payment
- Mortgage Amount = \$400,000
- Mortgage Details
 - Annual Interest Rate = 7%
 - Term = 30 Years
 - Monthly Mortgage
 Payment = ?

- Home Purchase
 - \$500,000 purchase price
 - \$100,000 down payment
 - Mortgage Amount = \$400,000
- Mortgage Details
 - Annual Interest Rate = 7%
 - Term = 30 Years
 - Monthly Mortgage
 Payment = \$2,661

• Home Purchase

- \$500,000 purchase price
- \$100,000 down payment
- Mortgage Amount = \$400,000
- Mortgage Details
 - Annual Interest Rate = 7%
 - Term = 30 Years
 - Monthly Mortgage
 Payment = \$2,661

Payment #	Mortgage Payment
1	\$2,661
2	\$2,661
3	\$2,661
4	\$2,661
5	\$2,661
6	\$2,661
7	\$2,661
8	\$2,661
9	\$2,661
10	\$2,661
11	\$2,661
12	\$2,661
Total	\$31,935

- Home Purchase
 - \$500,000 purchase price
 - \$100,000 down payment
 - Mortgage Amount = \$400,000
- Mortgage Details
 - Annual Interest Rate = 7%
 - Term = 30 Years
 - Monthly Mortgage
 Payment = \$2,661

Payment #	Mortgage Payment	Interest Expense	Loan Principal Reduction	Mortgage Balance
1	\$2,661	\$2,333	\$328	\$399,672
2	\$2,661	\$2,331	\$330	\$399,342
3	\$2,661	\$2,329	\$332	\$399,011
4	\$2,661	\$2,328	\$334	\$398,677
5	\$2,661	\$2,326	\$336	\$398,341
6	\$2,661	\$2,324	\$338	\$398,004
7	\$2,661	\$2,322	\$340	\$397,664
8	\$2,661	\$2,320	\$342	\$397,323
9	\$2,661	\$2,318	\$343	\$396,979
10	\$2,661	\$2,316	\$345	\$396,634
11	\$2,661	\$2,314	\$348	\$396,286
12	\$2,661	\$2,312	\$350	\$395,937
Total	\$31,935	\$27,871	\$4,063	

- Home Purchase
 - \$500,000 purchase price
 - \$100,000 down payment
 - Mortgage Amount = \$400,000
- Mortgage Details
 - Annual Interest Rate = 7%
 - Term = 30 Years
 - Monthly Mortgage
 Payment = \$2,661

Payment	Mortgage	Interest	Loan Principal	Mortgage
#	Payment	Expense	Reduction	Balance
1	\$2,661	\$2,333	\$328	\$399,672
2	\$2,661	\$2,331	\$330	\$399,342
3	\$2,661	\$2,329	\$332	\$399,011
4	\$2,661	\$2,328	\$334	\$398,677
5	\$2,661	\$2,326	\$336	\$398,341
6	\$2,661	\$2,324	\$338	\$398,004
7	\$2,661	\$2,322	\$340	\$397,664
8	\$2,661	\$2,320	\$342	\$397,323
9	\$2,661	\$2,318	\$343	\$396,979
10	\$2,661	\$2,316	\$345	\$396,634
11	\$2,661	\$2,314	\$348	\$396,286
12	\$2,661	\$2,312	\$350	\$395,937
Total	\$31,935	\$27,871	\$4,063	

In the 1st year, 87% of mortgage payments went to interest Only 13% reduced the mortgage principal!



Three Key Takeaways

- 1. A liability is anything you owe that has value
- 2. Paying off liabilities requires cashflow greater than debt service amounts
- 3. Loan payments first cover interest, then reduce what you owe.



Where to Learn More

- <u>Credit Tips for Teens</u> by Karon Warren via Investopedia
- <u>How Do Student Loans Work</u> by Jeff White
- <u>Teens' Guide to Building a</u> <u>Strong Personal Finance</u> <u>Education</u> by Nathan Paulus via MoneyGeek