Loan Basics

JEN: Ahhh. Finally some alone time.

SURFER: Did somebody say 'loan time'?

JEN: No. Nobody said loan time. I said alone time.

SURFER: Right on! Time for a loan!

JEN: No. I mean I want to be left alone.

SURFER: Clearly you're confused about how loans work. I was once that way too, little dudette. But don't worry. I can tell you all about it.

JEN: Great.

SURFER: Loans are like surfboards because there are different kinds to suit your individual needs. Student loans for tuition, mortgages for buying property, auto loans for getting a vehicle, small business loans for entrepreneurs and pay day loans. Although, to be honest, I'm not too stoked on those. They're kind of the worst.

JEN: So loans are tailored to the stuff that most people can't pay for upfront.

SURFER: Totally. A typical loan looks like this. There's the principal. That's the amount you're borrowing. Then there's the interest rate. That's a percentage that your financial institution charges you for lending you the money. Then there's the term. that's the amount of time you have to pay it all back.

JEN: That makes sense so far.

SURFER: Righteous. Loans can either be secured or unsecured, depending on whether or not they're protected by collateral. Collateral is something valuable that the lender can take as repayment if you default on your loan and can't pay it back. It's usually something big, like your house or a vehicle.

JEN: That sounds scary. Why even bother choosing a secured loan?

SURFER: Because secured loans usually have lower interest rates since they're less risky to the lender than an unsecured loan. Don't worry little dudette, they're only scary if you can't afford your loan.

JEN: Are there other ways to lower the interest rate?

SURFER: Interest rates are like ocean's tides. They're influenced by a ton of different factors and nobody knows how they actually work. Every lender is going to use a different set of factors to see whether or not you're eligible for a loan and what your interest rate will be. Factors like your credit score. Higher credit scores qualify you for lower rates, so it's worth it to get your score in shape before applying for a loan. The loan itself. The more you borrow and the longer the term, the higher the interest rate will be. Then there's your life situation. Lenders look for things that suggest you'll be able to pay back your loan. A good employment history helps. Not having any other debts help. Even having a long-standing relationship with the financial institution can help.

JEN: What about getting a co-signer?

SURFER: Totally excellent question surfer girl. A co-signer is like a surfing buddy. If you wipeout on your loan, he or she is the one responsible for its repayment. But being a co-signer is as risky as hanging ten in a hurricane because your credit history can be affected by the loan as if it were your own.
JEN: So it needs to be someone who trusts you a lot!

SURFER: Totally. I have one more surf tip for you and that's to see whether your loan has a variable or fixed rate. Fixed rates stay the same throughout the entire term of your loan, whereas variable rates are based on a chosen index. If that index goes up, so does your rate. If it goes down, so does your rate. Fixed rates are nice, constant and easy to plan for in your budget, but the interest on those is usually a little higher because the lender has to anticipate that the rates may rise in the future.

JEN: Like that giant wave over there?

SURFER: Surf's up! Later dudette. Awesome, ripping, oh, jellyfish.