



Money Matters Case Study: Understanding Credit Card Offers Scenario B

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Love and Money

Sally has been out of college for three years. She has a steady job that pays \$38,000 per year, drives an older car, and lives modestly. She has a few credit cards but uses them rarely and pays off the balance each month. She has paid off part of her student loans, including some of the principal besides the monthly payments. She has even saved \$20,000, which she keeps in a savings account earning 2% interest.

Sally has been thinking about taking some of her savings and investing it at a higher rate of return, although she expects to need it in 2 or 3 years when she plans to go to graduate school. She also wonders if her old car is going to last another 3 years as she believed when she got it. She is considering various options.

Sally's boyfriend Tom is about the same age as Sally, but he has more debt than she does and it is clearly bothering him. He wants to consolidate his credit card debt into a single loan at lower interest, because the credit card companies charge him a lot on his balance. He has approached Sally about a personal loan of \$10,000 dollars at an interest rate of 5%, more than twice what the bank is giving her. She feels he is basically a responsible person and knows he has a steady job. Sally wonders if she should let Tom borrow money and if so, how much.

Your analysis should include:

1. What questions should Sally ask Tom in order to decide if he is a "good risk"?
2. What options are available to Sally for investing her money, and what would be the return on each of these options?
3. In light of these options, what would a fair interest rate be on a loan to Tom?
4. If Sally were to lend Tom money, what would be fair terms for the loan? How often would Tom make payments, and what would they be? (The spreadsheet included with the credit card module will help with this question.)
5. What are the pluses and minuses of lending money to Tom? What are the best and worst case scenarios?

Based on your understanding of these issues and any other relevant considerations, what should Sally say to Tom? Prepare a written statement outlining your advice to Sally, along with justification of it.