

Lesson Plan 5: How do I get a mortgage?

SUBJECT(S): History, Geography, Economics

GRADE LEVEL: 7 - 10

DURATION: one class period

Objectives

Students will understand that:

- credit cards are relatively easy to obtain and it's easy to accumulate debt
- most major purchases, such as a house or car, require a loan from a bank
- good credit history is necessary to secure a loan

Students will be able to:

- research and compare interest rates
- develop a practical plan for budgeting and saving money
- solve simple problems involving rates

Warm-up/Discussion

Discuss good and bad credit. Share a story about your own experience borrowing money for a home or other large purchase and the role of credit in that transaction. Discuss the pitfalls of easy credit and the tendency that many people have to use credit cards when they don't have sufficient income to pay for something. What are the long-term consequences of this? What are the benefits of establishing a good credit history? What is the process for getting a mortgage to buy a home?

Learning Activities

Divide students into groups of three or four. Ask students to agree on a home they'd like to live in using the real estate section of the newspaper or an online real estate resource such as those below (or one of the homes they found in "Dollars and sense" Chapter 3; Lesson Plan 3 [pg. 95]) and explore the process of obtaining a mortgage for that home. What is the asking price of the home? How much would they need for a down payment?

Materials Included:

- Guide to Mortgages [pg. 105-107]

Additional Materials Needed:

- Copies of the mortgage rates section of the local paper
- If students have internet access, they can use the Fannie Mae website at <http://www.fanniemae.com/index.jhtml>

Vocabulary

credit:

an arrangement (usually with a bank) that one will pay later for something purchased now

credit card:

a card issued by a credit company that pays the store when you use the card to buy something and sends you a bill for the amount you spent. If you don't pay the bill in full each month, you'll owe the credit card company interest on the amount you don't pay.

interest:

a charge for a loan

interest rate:

the rate paid on borrowed money, expressed as a percentage of the amount borrowed

More terms specific to mortgages are included in the *Finding a Loan* handout.

Learning Activities (cont'd)

Discuss the positive and negative issues related to the ability to obtain credit cards easily. For example, discuss the accumulation of interest on unpaid purchases. People who continue to use credit cards without paying the entire amount owed have to pay a finance charge that is added to the balance each month. This means that they may pay significantly more than the purchase price for the things bought using credit. In fact, credit card companies call people who pay off the entire balance of their credit card each month “deadbeats.” Why would credit card companies not want people to pay off the entire balance each month?

Credit card companies often target teenagers, trying to get them to use credit cards (usually with a parent co-signing the agreement). Ask students whether they use credit cards. Has this been a problem, or do they see it as simply a convenient way to pay? Can they describe any situations in which someone they know has gotten into debt and couldn't afford to pay off the balance?

<http://www.chicagotribune.com>

<http://www.suntimes.com>

<http://www.chicagoreader.com>

Ask students to research on banks and other lending institutions in the Chicago region to compare interest rates and bring what they find to class. Use the *Guide to Mortgages* (pg. 105-107) handout as background for students. Lead a class discussion, asking students to explain why interest rates might differ from one institution to another.

Assessment

Write the vocabulary words and definitions on the board and ask students to match the definitions with the words.

Wrap-up/Reflection

Make two columns on the board and label them “Rent” and “Own”. Ask students to list the benefits of renting rather than buying a home. What are the benefits of buying a home rather than renting?

Ideas for Additional Activities

Economics: Students can calculate how much interest they would pay over three years if they bought an item costing \$500 with a credit card.

Guide to Mortgages

Name: _____

Date: _____

Amount of loan needed: _____

Type of mortgage: _____

Now you have to decide the type of mortgage you'd like. Read the description for each kind and make a choice. Use the attached "Guide to Mortgages" to explain the difference among mortgages.

| Bank or Lender | Interest Rate | Closing Costs | Points/fees |
|-----------------------|----------------------|----------------------|--------------------|
| | | | |
| | | | |
| | | | |
| | | | |

Find three banks or online lenders and collect the following information for the type of mortgage you have chosen:

Some terms you may encounter in your search:

APR or Annual Percentage Rate: calculated by using a standard formula, the APR shows the cost of a loan; expressed as a yearly interest rate; it includes the interest, points, mortgage insurance, and other fees associated with the loan

closing costs: fees charged in connection with a mortgage loan transaction, such as a loan origination fee, title examination and insurance, survey, attorney's fee, and prepaid items such as escrow deposits for taxes and insurance

conventional mortgage: a mortgage loan that is not insured or guaranteed by the federal government or one of its agencies, such as the FHA, VA or RHS

down payment: the amount of cash a buyer initially pays toward a purchase

escrow: money, property or a deed for property or a bond put into the custody of a third party for delivery to another party after certain conditions are met

Guide to Mortgages

The two most popular types of mortgages are the “Fixed Rate” and the “Adjustable Rate” or ARM. Two varieties of the fixed rate are included here.

FIXED RATE MORTGAGES

30-year fixed-rate mortgage

The most popular type of mortgage, the 30-year fixed-rate loan, is most appealing to borrowers who want to stay in their homes for a long period of time and who want to enjoy consistent interest payments during this period. Other benefits include keeping housing expenses to a minimum while maximizing mortgage interest deductions for income tax purposes.

KEY FEATURES

- this mortgage may require a low down payment, sometimes only 3 or 5 percent of the purchase price
- payments remain stable – the monthly mortgage payment will not increase
- the 30-year fixed-rate mortgage provides maximum interest deduction for tax savings

15-year fixed-rate mortgage

You pay off a 15-year fixed-rate mortgage in half the time it would take you to pay off the traditional 30-year fixed-rate mortgage. This shorter term makes it possible for you to build up equity in your home faster, which can let you move up more quickly to a more expensive home or save more in preparation for retirement or a child’s education. This loan is particularly attractive if you’re refinancing your mortgage because you can shorten your loan term and have a lower interest rate. Fifteen-year mortgages are usually offered at interest rates lower than those available with 30-year mortgages. However, higher monthly payments may make it more difficult to qualify for the 15-year fixed-rate mortgage compared to the 30-year fixed-rate mortgage.

KEY FEATURES

- a 15-year mortgage offers a lower interest rate than a 30- or 20-year mortgage. This saves you a significant amount of interest over the life of the loan. For example, with a \$100,000 loan at 8.25% interest, the 15-year mortgage will save you \$95,000 in interest payments over the life of your loan, compared to the same mortgage amount for a 30-year term. However, monthly mortgage payments will be higher.
- the shorter-term allows you to pay off your loan sooner

Guide to Mortgages (continued)

ADJUSTABLE RATE MORTGAGE

You may not expect to stay in the same home for 30 years. This is one reason to consider an adjustable-rate mortgage (ARM). An ARM generally offers a lower initial interest rate than a fixed-rate mortgage. With lower monthly payments in the initial years of your mortgage you may qualify for a larger mortgage amount.

AN ARM MIGHT BE A GOOD FIT IF:

- you plan to stay in your home for a relatively short period of time
- you want lower initial monthly payments and can handle potential payment increases in the future
- you want to qualify for a larger mortgage amount, and you expect your income to go up over time

KEY FEATURES

- you can select an ARM with a fixed-rate period of up to 10 years. The interest rate and your monthly payment stay the same during the fixed-rate period
- the interest rate adjusts (usually annually) based on a specific financial index. For example, one index is tied to the price of U.S. Treasury bills or securities
- an additional percentage, known as a “margin” may be added to the index value to determine your interest rate at the time of adjustment
- the rate moves up or down, depending on how interest rates have changed since you took out your loan. This means that when interest rates go up, your monthly mortgage payments may go up as well. On the other hand, when interest rates go down, your monthly mortgage payments may go down. ARMs typically have an interest rate cap (or maximum) on the periodic adjustments and for the life of the loan, so you know that your monthly payment cannot increase above a certain amount.

