Types of Debt

"Debt isn't bad, bad debt is bad" (Martin Lewis, Teen Cash Class lesson 2)

Debt is when you owe money to someone. Sometimes debt is necessary. Most people can't afford to buy a house without a **mortgage**, and expensive items are often bought with a **loan.** Debt is not bad if you are able to pay it back, but too much debt or debt that you cannot repay can lead to stress and all sorts of legal problems including **bankruptcy**. It is important to know that when you borrow money, you have to pay back that money plus extra which is called **interest**.

Mortgages

Mortgages are loans to buy a home. Mortgages are very long-term loans, typically over 25 years. This is called the "term" of the loan. You need a deposit of at least 5% of the value of the home, and you borrow the rest. You pay the money back each month. Most people have a "repayment mortgage" which means that you pay each month some of what you borrowed, plus interest. At the end of the term, you own the house.

If you cannot pay your mortgage repayment you risk the lender taking your home to repay your debt. This is called "repossession".

The Government has a scheme called "Help to buy" to assist first time buyers to buy a home.

Loans

A loan is a way of borrowing smaller amounts of money from banks, building societies or credit unions. You might take out a loan to buy a car or a new TV or sofa. The amount of money you can borrow will depend on your **credit rating**. This is a score based on how good you are at paying back money you borrow. If you have not repaid loans in the past, the lender might not risk lending you money in the future. How much you earn will also affect how much you can borrow and afford to pay back. Often you have to earn over £10,000 per year to take out a loan.

When you take out a loan it is important to look at the interest rate first to find out how much money you will have to pay back. The higher the interest rate is, the more expensive the loan. Avoid "loan sharks". These are people who are not legally allowed to lend money and they charge very high interest rates.

Credit cards and store cards

These cards let you buy items in shops and pay back some of what you owe each month. You will get a bill each month with a minimum amount to repay. If you only pay the minimum you will pay the debt for a long time as you will pay interest each month on the amount you have not repaid (the debt). If you buy something with a credit card and pay it all back when the bill arrives you do not pay any interest. The interest rates on credit cards are higher than for loans. Remember that if you do not pay what you owe, your debt increases as you are charged a "late payment fee". If you still don't pay, the lender can take you to court or send the **bailiffs** to take property to the value of what you owe them.

Only borrow what you can afford to pay back