FREE PRACTICE | LIFEREADY

Loan Comparison Lab

Principal is the amount borrowed. Interest is a cost of using that money. A term is the repayment length. APR expresses borrowing cost including specified fees under applicable rules; it can differ from the interest rate. Compare the same type of cost and check fees, payment timing, and contract terms.

Worked example: fictional $1,200 loan

Assume a fixed 12% annual rate, no fees, monthly compounding, and equal end-of-month payments. Monthly rate r = 0.12 / 12 = 0.01. Payment = P x r / [1 - (1 + r)^(-n)], where P is principal and n is number of payments. Rounded examples follow.

Offer	Monthly payment	Total paid / interest
12 months	$106.62	$1,279.44 / $79.44
24 months	$56.49	$1,355.76 / $155.76

Totals multiply rounded payments; a real final payment may adjust by a few cents. Here rate and APR coincide because no fees apply. Daily interest, fees, or other terms would change results.

Compare, then decide

1. How much lower is the 24-month payment? How much higher is its illustrated total interest?

2. If a lender advertises only '$56.49 a month,' name three missing facts you would request.

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LOAN COMPARISON LAB

Check, explain, and apply

Worked answers

1. Monthly difference = $106.62 - $56.49 = $50.13. Illustrated interest difference = $155.76 - $79.44 = $76.32. A smaller payment eases the monthly budget here but keeps the debt longer and increases total interest.

2. Ask for principal, APR, interest rate, repayment term, total payments, fees, payment schedule, and any penalties or security requirements. A payment amount alone cannot show whether an offer is affordable or low cost.

First-payment check

For the 12-month offer, first-month interest is $1,200 x 0.01 = $12. Principal repaid is $106.62 - $12 = $94.62. New balance is $1,200 - $94.62 = $1,105.38. The whole payment does not reduce principal because some pays interest.

Extend the model

1. Using that rounded balance, calculate month-two interest, principal repaid, and balance. Round each step to cents.

Model result: interest $11.05; principal $95.57; balance $1,009.81. This rounding convention may differ from an actual lender's method. Secured borrowing can put pledged property at risk; private and federal student loans have different terms and protections.

Source: consumerfinance.gov/ask-cfpb/what-is-the-difference-between-a-loan-interest-rate-and-the-apr-en-733/ . Educational practice, not individualized financial, legal, tax, or investment advice. Examples are fictional. U.S. rules and account terms can vary.

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