

2

Principal, Interest, Rate

L4.8.2 · THE VOCABULARY OF BORROWING

I CAN

define the parts of a loan and explain what each one costs me

| TERM            | YOUR DEFINITION | DOES IT INCREASE WHAT I REPAY? |
|-----------------|-----------------|--------------------------------|
| Principal       |                 |                                |
| Interest        |                 |                                |
| Interest rate   |                 |                                |
| APR             |                 |                                |
| Origination fee |                 |                                |
| Term            |                 |                                |

Federal undergraduate Direct Loans carry a **fixed** rate — it does not change over the life of the loan. Why does that matter more than a low starting rate on a private loan?

# Answers and talking points

What a good answer looks like, and one question to ask when the pencils go down.

| Term            | What it means                                       | Does it increase what I repay?                              |
|-----------------|-----------------------------------------------------|-------------------------------------------------------------|
| Principal       | The amount actually borrowed                        | No — it is the starting amount                              |
| Interest        | What the lender charges for the use of the money    | Yes                                                         |
| Interest rate   | Interest as a percentage of the principal, per year | Yes                                                         |
| APR             | Interest rate plus fees, as one yearly percentage   | Yes — and it is the honest number to compare                |
| Origination fee | A charge taken out when the loan is issued          | Yes — you repay it even though you never received it        |
| Term            | How long you have to repay                          | Yes — a longer term lowers the payment and raises the total |

## 9–12 Why a fixed rate matters more than a low starting rate

Federal undergraduate Direct Loans are **fixed**: the rate is set when the loan is made and cannot move for the life of it. A private loan advertised at a lower rate is usually **variable**, so the payment a family budgeted for can rise years later, with no cap a student can rely on. **A rate you can plan around beats a rate that merely starts lower.**

*Ask: “Who carries the risk if rates go up — you or the lender?” On a fixed loan the lender does. On a variable one, the student does.*

## 9–12 The two students miss most often

**Origination fee** and **term**. A fee is deducted before the money reaches you, so you borrow \$10,000, receive about \$9,895, and repay the full \$10,000 with interest. And a longer term feels cheaper every month while costing more in total — the single most common trap in all consumer borrowing.

*Ask: “Would you rather pay \$200 a month for 10 years or \$300 for 6?” Work out both totals before anyone answers.*

## Want the rest of the unit?

This page is one activity, unchanged, from **Unit 4.8 — Student Loans and Smart Borrowing**, a Financial Foundations™ unit of 10 to 12 lessons with teacher scripts, family letters and a unit checkpoint. For a free five-day money game your students can play in a browser, try **The \$100 Week™**. Everything is at [wealthwisekids.org](https://wealthwisekids.org).