Case study 2

A new life in London

Grace is 23 and has been working in an administrative role for a car company in her home city of Nottingham since finishing her degree two years ago. She lives at home with her parents and younger sister. Grace gained her degree in Criminology at the University of Liverpool and has been searching for her dream job working in criminal psychology.

Grace has always been careful with her money. When she was at university, Grace worked for the car company in the summer holidays to repay her overdrafts and other debts. This has meant that she has left university with only her student loan remaining as unpaid debt. When Grace finished university, her parents bought her a new car, and she has been paying for the insurance and maintenance since then.

Grace has now been successful in getting a job as a junior criminal psychologist and will be working in London. She is due to start next month and has been busy preparing for her relocation to London. Grace has sold her car, as she will not need this due to the good London transport infrastructure. With her small savings and money from the car, this will help Grace pay her rent deposit as well as set her up with furniture in the new flat.

Grace has remained in contact with three friends from university, and they have also managed to secure new jobs in London that start over the next month. This has meant that Grace's new flat will be shared by all four friends together and that they will be sharing a large flat in Canada Water, dividing the rent and bills equally.

Grace and her friends have set up a joint account and have worked out that their rent and bills will come to £4,000 per month, so they have set up a standing order of £1,000 per month each.

Grace's new job pays a starting salary of £25,000 per annum, so she is confident that she can afford this £1,000 per month contribution. Grace is looking forward to experiencing the diversity that London has to offer.

Grace's new role is based in various parts of central London, and she will have to pay for her own travel costs. She may occasionally be required to work in various parts of

the South of England, but she will be reimbursed of any expenses within 60 days of travel, which is part of the company's policy. In preparation for this, Grace has applied and been accepted for a new £500 overdraft on her current account with her bank.

Research

The Money Advice Service provides the following information on how overdrafts work.

"Types of overdraft

Authorised overdrafts are arranged in advance, so they're also known as 'arranged' overdrafts. You agree a limit with your bank and can spend money up to that limit.

Unauthorised overdrafts: these are also known as 'unplanned' or 'unarranged' overdrafts and happen when you spend more than you have in your bank account without agreeing it in advance. This includes going over the limit of an authorised overdraft.

Major changes affecting the cost of overdrafts were introduced in April 2020. Banks used to charge higher fees for unauthorised overdrafts, but since April 2020 they are not allowed to do this.

Interest on all overdrafts is charged at a single annual interest rate (APR), making it easier to compare charges between accounts. Interest rates from banks and building societies on their overdrafts range from 19% to 40% or more.

Do you need an overdraft?

If you find yourself dipping into your overdraft frequently, you might want to use our Budget Planner to take control of your money.

The Financial Conduct Authority (FCA) found that many people underestimate how much they use their overdrafts. If you're using your overdraft more than you think, it might be costing you more than you realise.

If you're using your overdraft a lot, read our tips below on how to avoid doing this. They might help you save money. If you find you're constantly in your overdraft and don't have the money to pay it down quickly, it might be cheaper to borrow using a personal loan or 0% credit card.

Search for a better current account

If you don't use the right account, overdrafts can be one of the most expensive ways to borrow in the long term. Comparison websites can help you find a current account tailored to your needs.

Tips for controlling your overdraft

Keep an eye on your account balance.

Keeping track of your account balance is one of the best ways to avoid overdraft costs.

Make it as easy as possible by:

- downloading your bank's app if you have a smartphone
- setting up text alerts for when your balance is low
- using phone banking.

Use savings if you have some

If you have savings as well as an overdraft, it'll be cheaper in the long run to use your savings to pay it off. If you then get an unexpected cost, you can still use your overdraft to pay for it. And if you don't, you can start building up your savings again so you're ready for that unexpected expense.

Find ways to live on a budget

To lower your overdraft as quickly as possible, cutting back spending will help you free up money. The money you save can then be used to pay off your overdraft.

Beware – your bank overdraft could be taken away

One reason that an overdraft isn't safe for long-term borrowing is that it's not guaranteed.. The bank could take it away at any time.

But if your bank cancels your overdraft with no warning and you are charged as a result, you might have grounds to complain.

If you complain to your bank and you aren't satisfied with the outcome, you can take your complaint to the Financial Ombudsman Service."

(*Source*: www.moneyhelper.org.uk)

The next article is from *The Times* and looks at the frequently asked questions about the possible impacts of having an overdraft.

"Does an overdraft appear on my credit report?

Yes. Credit reports track how you deal with debts such as overdrafts. They help potential new lenders decide if you are likely to be a responsible customer for products such as mortgages – affecting the interest rate you are offered, the size of any credit limit and whether you are accepted for the loan at all.

Your bank or building society will tell the credit-reference agencies each month whether you have used your overdraft – and if so, how much you have borrowed.

Does applying for an overdraft affect credit score?

If you apply for a current account that comes with an overdraft, the bank or building society will look closely at your credit history (known as a 'hard search') to see if you are a good bet as a borrower.

Lenders may come over all Sherlock Holmes, viewing several hard searches in a short space of time as a sign that you have financial difficulties, because either you suddenly need to borrow lots of money, or your applications are being turned down.

Does being overdrawn affect your credit rating?

Borrowing will affect your credit rating, in that your credit report tots up all your unsecured loans – so not just overdrafts but also debts such as credit card balances and personal loans.

If you owe a lot of money compared to your income, with a whacking great overdraft on top of a mountain of other debt, you could start losing points from your credit score.

However, what's really important is how you manage your overdraft – and your ability to prove you are a responsible borrower.

James Jones, head of consumer affairs at credit-reference agency Experian, explains: 'If you keep within your agreed overdraft limit, keep the amount down and don't have any payments refused, it will have a positive impact on your credit score.'

In contrast, if you stray over your overdraft limit, use an unauthorised overdraft repeatedly or have cheques or direct debits refused, these could all damage your credit rating.

Does increasing your overdraft affect your credit rating?

If you apply for a bigger overdraft, your bank or building society may carry out another hard search of your credit report.

Again, this could result in your credit score dipping a few points for a few months.

Using more of your overdraft will push up your total debts and could therefore push down your credit rating. Think of your overdraft as a limit, not a target!

However, it's far better for your credit rating if you arrange a larger overdraft with your bank, rather than going over a lower limit without asking them.

Does reducing your overdraft affect your credit rating?

In general, the lower your borrowing, the better. Lenders also prefer to see a trend towards borrowing less, rather than more."

(*Source:* www.thetimes.co.uk)

Case study 2

ADDITIONAL INFORMATION:

Grace has now moved to London and has settled in. She has used most of her savings and money from the sale of her car on her deposit and furnishings. She has £400 left and the overdraft hasn't been used.

Grace, with her friends, has joined a local gym costing £50 per month. Grace has never used a gym before but is looking forward to this being part of her new experiences.

Case study questions

2	1	Analyse what potential benefits there could be for Grace in having an overdraft.	(10 marks)
2	2	Describe the main reasons that someone like Grace should monitor her spending.	(5 marks)
2	3	Analyse the external factors that could influence Grace's current financial position.	(5 marks)
2	4	Evaluate why it is important for Grace to be concerned about financial planning at her stage of the life cycle.	(15 marks + 5 marks SPAG)