UK COOPERATIVE EXTENSION SERVICE
UNIVERSITY OF KENTUCKY—COLLEGE OF AGRICULTURE

MONEY MANAGEMENT

How to Manage Credit

Credit is a service that lets you buy now and pay later. You use someone else's money to buy something you want to use now. Credit means using your money from future paychecks to pay for something you buy now.

When you borrow, you promise to do the following:

- Pay back the amount of money you borrow plus the additional charge for using that money
- Pay back your debt regardless of personal crises or unexpected situations
- Make your payments on time
- Not sell any item that has been used as collateral until all payments have been made
- Give back what you are buying if you can't finish paying for it
- Take responsibility for any damages done to the item that you bought on credit if it has to be returned to the store

Types of Credit

Credit is available in several forms: mortgage, home equity loan, service credit, loans, installment credit, charge cards, and credit cards.

You may borrow money to purchase a home. That is called a **mortgage**. A mortgage is a debt used to purchase property. It has two parts: the note and the mortgage. The note is the IOU that states the terms under which you promise to repay the borrowed money. The mortgage, or deed of trust, is the property you pledge as security to the lender. That means the lender can take over your property if you fail to make your mortgage payments.

A **home equity loan** is a modern version of the second mortgage. Your home is used as security for a loan for items that require a sizeable amount of cash. This type of loan may be used to finance expenses such as major home improvements, college expenses, or large medical bills.

You use **service credit** when you use your telephone, electricity, or gas for a month. You don't have to pay for using the services until the end of the month.

A **consumer cash loan** is a type of credit where you borrow cash from a second party (ABC Bank) to buy an item from another source (for example, XYZ Store). Let's say you want to buy a stereo that cost $1,200. You don't have $1,200 in cash, so you borrow the money from your local bank. You, in turn, give the borrowed money to the XYZ Department Store for the stereo.

A consumer cash loan or personal loan may be secured or unsecured. **Unsecured loans** are loans you can get on the basis of your signature, your income level, and good credit rating. **Secured loans** are made by pledging personal assets such as an automobile or a savings account or by cosigning with another person. A loan that is secured with personal assets such as stocks, bonds, a car, or the item you purchase provides the lender with property in case you fail to make your payments. Using your savings account as collateral at a local bank is a good way to establish or re-establish credit. If you cosign, the person who signs the loan with you agrees to pay off the loan if you don't. Consumer loans are available through banks, credit unions, small loan companies, insurance companies, friends, or relatives.

With **installment credit**, you can borrow money or purchase goods and repay in equal weekly or monthly amounts. You can also arrange your payment so the loan is due in 30, 60, or 90 days. Find out if your loan will be with the store where you purchase the item or from a finance company.

When shopping for credit, remember two terms: finance charge and annual percentage rate.

Credit cards are a popular form of credit. Credit cards are a form of revolving credit. Revolving charge accounts allow you to borrow at any time, in any amount up to a maximum credit limit.

Credit cards come in two types:

- **Single purpose cards** such as retail department store cards and major oil company cards are limited to use in that store or with the oil company.
- **Comprehensive cards** are widely accepted by hotels, motels, restaurants, airlines, major department stores, and other businesses. Visa and MasterCard are examples of comprehensive cards. Some comprehensive credit card accounts charge an annual fee for using the card.

Charge cards require the user to pay the balance in full at the end of the billing period, usually 30 days. This type of account also charges an annual fee. The amount of the annual fee will vary depending on the type of account you have. Many issuing companies have different levels of cards. For example, it might be a gold card, silver card, or platinum card.

How Much Does Credit Cost?

When you buy on credit, you use someone else's money so you can buy something now. The price you pay for using that money is called **interest.** Interest varies from creditor to creditor, so shop around, and ask the following questions:

- What is the annual percentage rate?
- What is the total cost of the loan in dollar amounts?
- How long do you have to pay off the loan?
- What are the number, amounts, and due dates of payments?
- What is the cost of extending the time period for paying back the loan?
- What is the cost of late charges for overdue payments?
- If you pay the loan off early, are there any pre-payment penalties?
- Does the loan have to be secured? If so, what collateral is required?
- What is the cost of credit life or other insurance that is being offered or that may be required?
- Are there any other charges you have to pay?

When shopping for credit, remember two terms: finance charge and annual percentage rate. If you remember these terms, you can find out how much you will pay for credit and can compare the costs of credit among the various lenders.

The **finance charge** is the total price you have to pay to borrow money. The finance charge is made up of two parts: interest and carrying costs. Interest is the portion of the finance charge you pay for actually borrowing the money. **Carrying costs** are the expenses the lender has to charge for the service of providing credit to you. Some of the lender's charges include bookkeeping, credit investigation, and maintenance fees. If you choose to carry credit life, credit accident and health, or credit property insurance, that is also added to the borrowing cost. Because credit costs vary so much from lender to lender, the **annual percentage rate** (APR) is used to state the cost of credit. The APR gives a way to compare credit costs on an equal basis.

Factors Affecting Credit Costs

The cost of credit depends on who you borrow from, your credit history, how much you borrow, and how long you take to repay.

Who You Borrow From

Different creditors charge different rates for borrowing. Before you borrow, compare costs at three or more places.

Your Credit History

Your credit history shows your ability and willingness to repay a debt. It is measured by your record of paying bills. It is determined by how prompt and reliable you have been in making past credit payments. A good credit history helps you qualify for credit and helps you get credit at a lower cost.

Most lenders today use a credit score to determine objectively what the terms of your credit will be. The credit score is weighted on several factors. Different lenders calculate the credit score with their own weighted formula. No one has just one credit score. This objective measure eliminates subjective discrimination by a lender.

How Much You Borrow

The less money you need to borrow, the less the credit will cost. For example, let's say you want to buy a used car for $6,000. You want to pay for it in two years. The annual percentage rate is 12 percent. Compare the cost of credit between borrowing the entire $6,000 and making a $1,000 down payment or a $2,000 down payment (Table 1). As Table 1 shows, if you have no down payment and borrow the entire $6,000, the finance charge is $778.56. If you borrow $5,000, the finance charge is $648.88. If you borrow $4,000, the cost is $518.96, or $259.60 less than with no down payment.

The larger the down payment you make, the lower the finance charge you will pay. A bigger down payment reduces your monthly payment.

How Long You Take to Repay

The longer you take to repay your debt, the more you will pay. A longer repayment period may lower your monthly payment but add to the total cost of borrowing. For example, let's say you want to buy the same $6,000 car at 12 percent annual percentage rate with no down payment. The cost will vary with how long you take to pay. Compare the costs for two, three, or four years of financing (see Table 2). The total cost over two years would be $6,778.56. For four years it would be $7,584. The difference is $805.44.

Take the shortest amount of time to repay a debt and make the highest monthly payment you can safely afford.

Credit Insurance

When you apply for credit, you will frequently be offered credit insurance. Credit insurance is often sold by banks, savings and loan associations, small loan companies, department stores, automobile dealers, and others at the time the credit is granted. This form of credit insurance is usually decreasing term insurance. A less expensive option

Table 1. How down payments reduce the cost of borrowing (12% APR).

Down Payment	Amount Financed	Monthly Payment (rounded)	Total Finance Charge	Total Repayment
$ 0	$6,000	$282.44	$778.59	$6,778.56
1,000	5,000	$235.37	$648.88	$5,648.88
2,000	4,000	$188.29	$518.96	$4,518.96

Table 2. How length of time to repay reduces the cost of borrowing (18% APR).

Time to Repay	Amount Financed	Monthly Payment (rounded)	Total Finance Cost	Total Cost
2 years	$6,000	$282.44	$778.56	$6,778.56
3 years	$6,000	$199.29	$1,174.44	$7,174.44
4 years	$6,000	$158.00	$1,584.00	$7,584.00

Be careful about co-signing a loan or credit card for someone else.

is to purchase term insurance from a regular insurance company to protect your assets should you die prematurely or become disabled.

Different kinds of credit insurance protect you in different ways. For example,

- **Credit life insurance** pays off the loan if the borrower dies.
- **Credit accident and health insurance** or **a disability rider** insures that your payments will be made even if you become ill or disabled and can't work.
- **Credit property insurance** will pay for the goods if they are stolen or destroyed.

Since credit insurance is relatively small compared to the loan, it's an often overlooked item. Read all loan and credit contracts closely to see if this insurance is included, under what conditions, and at what costs.

It's to the lender's advantage to get you to sign for credit insurance. Lenders are like insurance agents. They make a commission on each policy sold. But consumers often don't want it, may not need it, and often don't realize they are buying it.

Some consumers quickly sign but do not read their loan contracts because they need the money and do not feel that they are in a position to ask questions. Other consumers may feel that if they turn down credit insurance, they may harm their chances of being approved for credit. So they sign without question.

A consumer already adequately covered by life, health, and disability insurance at work or through a private plan may not want the extra coverage. If you are already covered by one of these plans, payments will continue to be made on the loan even though you may become ill or disabled or die. Similarly, a person on social security or in the armed forces would have an income even if disabled, so again credit disability insurance would not be needed.

Review your present insurance coverage. If it is adequate, there is no reason to buy more. If the amount of the loan is small, you may not need credit insurance coverage at all.

Where to Go for a Loan

When you need to borrow money, you don't want to just walk into the first lending institution you see to borrow money. Look around to find the lender who can give you the least expensive loan. You can borrow money from a variety of places, including friends and relatives, credit unions, local banks, your life insurance company, finance companies, savings and loan companies, your retirement fund company, pawn shops, payday loan offices, check-and-go offices, illegal lenders, or loan sharks.

The last four options are examples of predatory lending and should be avoided. The interest rates charged are almost impossible to repay, and the amount you owe continues to increase as interest payments not made are added to the principal owed. Borrowing from your insurance policy or your retirement funds should also be a last resort. You will reduce your life proceeds should you die before you repay the loan. Your retirement fund will have less money for compounding and growing, thus reducing the advantage of time for your retirement investment. Finance companies usually charge higher interest rates and fees. Borrowing from a finance company has a negative effect on your credit history. Borrowing from friends and relatives can cause problems in the relationship if you do not repay the loan. Financial institutions such as banks, credit unions, or savings and loan companies are considered the most reasonable places to borrow money.

Be careful about co-signing a loan or credit card for someone else. All activity on his or her account—including the outstanding balance—will also be reflected on your credit history. It can have a dangerous effect on your credit ratings if the other person is not responsible. You could end up in a situation where you cannot obtain credit.

Should You Use Credit?

Before buying an item on credit, ask yourself if you can justify using credit rather than waiting to buy the item when you have the cash.

The Cost

- Is it worth the extra cost to buy on credit?
- Is this something I really need?
- Is this something I have planned in my budget?
- Can I make payments?
- Have I tried to be exact in estimating my other expenses?

The Risk

- Could I still pay if I am sick or have an accident?
- Is it worth losing the money I have paid if I miss a payment or cannot finish paying for the item?
- Do I want to risk repossession, a bad credit history, or legal action if I can't pay for all of it?

The Obligation

- Can I afford to tie up my future income?
- Am I borrowing from a fair and honest person?
- Do I understand what the contract says?
- Will I still want to be paying for this item for the length of the contract?
- Would it be wiser to save my money and buy this later?

Will You Be Granted Credit?

Have you ever wondered how banks or other lending institutions decide if they will lend you money? Before a bank or any other lending institution will lend you money, they try to determine if you are a good credit risk. The lending institutions look at the several factors to judge your ability and willingness to repay your debts: income, occupation, stability in life, credit history, and assets.

Income

- Do you have a steady source of income?
- How large is your income?
- How dependable is your income?
- What are the demands on your income?
- How many dependents do you support?
- What are your outstanding debts?

Occupation

- Do you have a good employment record?
- Are you self-employed?
- Are you regularly or seasonally employed?
- How long have you been employed?
- What is your occupation? (Businesses have found that people in certain occupations are more likely to repay debts than others.)

Stability

- Do you display stability in your life?
- How long have you lived at your current residence?
- How long have you been employed at your present job?
- Do you own your residence?

Credit History

- Have you paid your bills in the past?
- Do you pay bills on time, late, or not at all?

Assets

- Do you have checking and savings accounts?
- Do you have property or investments that could be used as security or collateral?

Will You Be Turned Down for Credit?

The Federal Reserve Board is responsible for administering federal credit policy. The board suggests that creditors offer the following reasons for denying credit:

- Credit application incomplete
- Insufficient credit references
- Unable to verify credit references
- Temporary or irregular employment
- Unable to verify employment
- Length of employment (You may not have worked at one job long enough.)
- Insufficient income
- Excessive debts
- Inadequate collateral
- Too short a period of residence
- Temporary residence
- Unable to verify residence
- No credit file
- Insufficient credit file
- Garnishment, attachment, repossession, or lawsuit
- Bankruptcy

Buying on Credit

Advantages

- If you lack the discipline or time to save money, credit is a way to buy consumer goods.
- Credit is handy and convenient.
- Credit allows you to use an item while you are paying for it.
- If the purchased item is faulty and needs repairing or replacing, you could hold up your finance payment until you receive appropriate action from the seller.
- Establishing a good credit rating will make it easier for you to get credit for emergencies.
- Credit is a type of forced savings. (If you spend $10 a week doing laundry outside your home, the $10 could be used to pay for a washer. After the washer is paid for, you won't have the $10 laundry bill.)
- If you carry credit cards, you can carry less cash.
- You can satisfy immediate needs.
- You can take advantage of sales even though you can't pay for items right then.

Disadvantages

- The use of credit adds additional cost to the original purchase price of an item.
- With credit, you may buy more than you can afford. (If you do not pay for the items, the store can repossess or take them back.)
- You may be discouraged from comparison shopping to get the best buy. (If you only have the credit at one store, you may miss bargains at other stores where you don't have credit.)
- If you don't understand the credit contract, you may agree to something you don't really intend to.
- Overuse and abuse of credit can lead to a poor credit rating.
- The use of credit ties up money out of paychecks in the coming months.
- By using credit, you may tie up income needed for necessities.
- Tying up income in repaying debt keeps you from having money to save and invest for the future.

The use of credit adds additional cost to the original purchase price of an item.

Reducing the Cost of Credit

You can reduce the cost you pay for credit if you:

- Make as large a down payment as possible.
- Borrow the least amount possible.
- Shop around for the lowest annual percentage rate.
- Pay back the loan as fast as you can; pay back in less time, such as one year instead of two.
- Arrange the highest monthly payment you can afford.
- Pay your bills on time, which protects your credit rating.
- Only use credit when you really need it.

Married Women and Credit

Married women often use credit accounts listed in their husband's name. They think they have credit in their own name. In reality, the credit is only being reported in the husband's name.

What about your credit history? Do you have your own credit identity, or is everything reported in your husband's name? If you were suddenly divorced or widowed, would you be able to borrow money, get a credit card, or rent an apartment? If you don't have your own credit history, you may find yourself in a financial jam.

The Equal Credit Opportunity Act gives women a way to establish their own credit history and identity. Your own credit means a separate account or loan in your own name—not a joint account with your husband or a duplicate record on his account.

You have a right to your own credit, based on your own credit records and earnings. You cannot be denied credit just because you are a woman, or just because you are married, single, widowed, divorced, or separated.

Use your own name when you apply for credit. If Mary Ann Jones married Richard Smith, she could choose Mary Ann Jones, Mary Jones, Mary Ann Smith, Mary Jones Smith, Mary Ann Jones Smith, or Mary Smith. Any of these names are legal. Just pick one and use it consistently so there is no indication of fraud. DO NOT use your social title, such as Mrs. Richard Smith. That credit information would go in your husband's file.

Make sure that accounts you share with your husband are being reported under BOTH your name and your husband's name. To make sure that all accounts are being credited to your history, write your creditors and request that credit information also be reported in your name as it appears on the billing statement. Provide your address, the account number, and your name as it should appear in the credit file.

Establishing a Credit History

Following are some steps you can take to establish your credit history and show creditors that you are credit worthy.

- Open a checking and savings account in your own name. (This alone doesn't prove you are credit worthy, but it does indicate that you can handle money in a businesslike manner.)
- Open a retail charge account. Start an account in your name at a local store. Charge some purchases and pay your bill promptly.
- Apply for a bank credit card. (Banks often require that you have a savings account with the institution or a cosigner before they will issue you a card. They give you a limit on the amount you can charge. This amount increases as your income and credit history improve.)
- Take out a small loan and repay it promptly. (You may not be eligible for enough to buy a car, but you probably will be eligible for a small loan.)

Keep a Good Credit History

Pay your bills promptly. If you have trouble making payments, visit your creditor. Try to work out a solution. Perhaps you can make smaller payments or delay payments for awhile.

Do NOT avoid your creditor. Don't act as if you have no intention of paying your bill. This will hurt your credit rating seriously and make it hard for you to get credit again.

How to Obtain a Copy of Your Credit Record

Credit reporting agencies (CRA) maintain credit records. You can obtain a copy of your credit record by contacting each of the three major credit reporting agencies. Every consumer can obtain one free copy per year (12-month period) from each credit reporting agency. The free credit record can be obtained over the internet, by mail, or by phone. You may order your reports from each of the three nationwide consumer reporting agencies at the same time, or you can order from only one or two of the CRA's at a time. It might be a good idea to stagger your requests for your free credit reports during the year in order to have a new report approximately every four months.

It is a good practice to check your credit report on a regular basis. Mistakes do happen! Checking your credit report also can help guard against identity theft. If you're thinking about buying a home or a car, checking in advance on the accuracy of the information in your credit report could help speed up the approval process.

To order your credit record from the Internet, go to: http://www.annualcreditreport.com and follow the instructions to complete the request form online. When you order your credit report online, you can view it immediately at each CRA. The report is kept open for you to read for up to 30 days. You can print a copy for your personal records from the Web site.

To order your credit record by phone, call 877-322-8228. You will go through a simple verification process over the phone. Your reports will be mailed to you.

To order your credit record by mail, you can fill out the request form online at www.annualcreditreport.com and mail it to: Annual Credit Report Request Service, P.O. Box 105281, Atlanta, Georgia, 30348-5281.

If you want another copy of your credit from the same CRA within a 12-month period, or if you order directly from the CRA and not through the unified Annual Credit Report service, you will be charged a fee (generally around $10 for an individual report or $20 for a couple). Beware of misleading "free credit report" services provided by lenders and other Internet sites. They may actually be similar to an application for credit that will show up on your credit report as an inquiry and will stimulate never-ending solicitations for credit.

When ordering a Credit report (whether free or not), you also can request a credit score (numerical summaries of your credit-worthiness based on information from CRAs). However, you will be required to pay a fee for the credit score.

When you are denied credit, insurance, or employment because of negative information in your credit report you can also obtain a free copy of your credit record. It is important that you check to make sure the credit report is accurate! Check the denial notice that you received. It must provide you with the name, address, and telephone number of the CRA providing the report. If you contact this CRA promptly (within 60 days of receiving the notice), you can get a copy of your credit report free of charge.

Credit Reporting Companies

The three major credit reporting companies in the United States are:

Experian
888-397-3742
http://www.experian.com/consumer

Equifax Credit Information Services
Disclosure Department
P.O. Box 740241
Atlanta, Georgia 30374
800-685-1111
http://www.equifax.com

TransUnion Consumer Solutions
P.O. Box 2000
Chester, PA 19022-2000
1-877-322-8228
http://www.transunion.com

It is important that you check to make sure the credit report is accurate!

You will be required to identify yourself to the credit reporting agency's satisfaction. The information you will be asked to provide is: name, address, previous address (if within last two years), social security number, date of birth, current employer, phone number. If a spouse is also checking, information on both people must be included.

The credit reporting agencies gather and sell credit information about consumers. When a creditor asks a CRA for a credit report, the CRA sends the creditor whatever information if has on file about you. The CRA typically reports:

- How many and what kind of credit accounts you have
- If you pay your bills on time
- Whether you've ever filed bankruptcy or been sued

The CRA obtains the information from creditors who have accounts with the CRA or from daily court records.

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