

Financial Literacy Money Trek

MODULE 4B - BORROWING & CREDIT

PREPARED BY: FINANCIAL LITERACY COMMITTEE, AAUW CALIFORNIA

Objectives of this Module

- Describe how credit works and types of credit available.
- Understand how to use credit appropriately.
- Understand the forms of credit and loans.
- Identify the costs associated with loans.
- Determine if you are ready to apply for credit.



Credit

Credit is money you borrow to pay for material and services.

It is also called a loan.

“Good” credit means making payments on time.

“Bad” credit means it will be harder to borrow in the future.



Why Credit Is Important

- It can be useful in emergencies.
- It's more convenient than carrying cash.
- It lets you make large purchases.
- It can affect your ability to get employment, housing, and insurance.



Types of Loans

Consumer installment loans

Credit cards

Home loans



Consumer Installment Loan

A loan used to pay for personal expenses:

- Automobile
- Computer
- Furniture



Credit Cards

Give you the ongoing ability to borrow money for:

- Household
- Family
- Personal

Module 3 for detail.



Home Loans

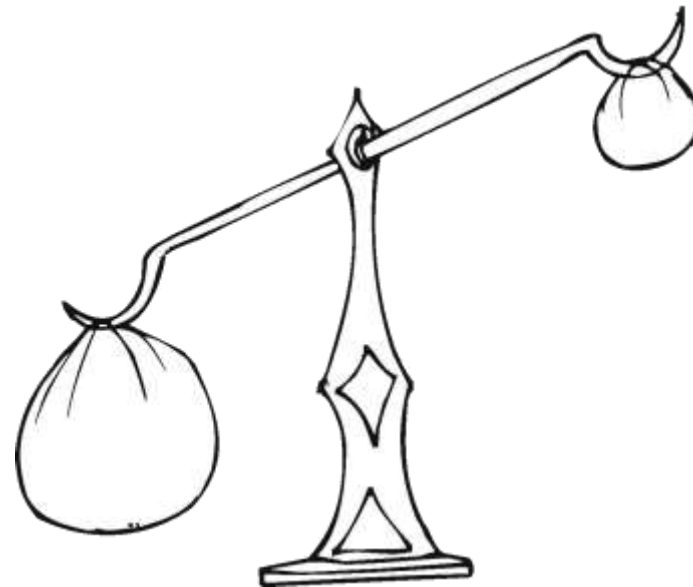
- Home purchase loans
- Home refinance loans
- Home equity loans



The Cost of Credit

There are two types of costs associated with credit/loans.

- Fees
- Interest



Fees

- Annual maintenance fees
- Service charges
- Late fees



Interest

- The money financial institutions charge for letting you use their money.
- The rate of interest is either Fixed or Variable.
 - Fixed: Interest rate stays the same during the term of the loan.
 - Variable: Interest rate may change during the loan's term.



The “Four Cs” of Credit Decision Making

- Capacity
- Capital
- Character
- Collateral



Capacity

- Do you have a job?
- How much money do you make?
- What are your monthly expenses?



Capital

- How much money do you have in your checking and savings accounts?
- Do you have other investments or assets?



Character

- Have you had credit in the past?
- How many credit accounts do you have?



Collateral

- Do you have assets to provide to secure the loan beyond your capacity to pay the loan?



Advantages of Credit

- You're able to buy needed items now.
- You do not have to carry cash.
- It creates a record of purchases.
- It is more convenient than writing checks.
- Can consolidate bills into one payment.



Disadvantages of Credit

- Interest (it ends up costing more).
- May require additional fees.
- Financial difficulties may arise if one loses track of how much has been spent each month.
- Increased impulse buying may occur.



Your Responsibilities

- Borrow only what you can repay.
- Read and understand the credit contract.
- Pay debts promptly.
- Notify creditor if you cannot meet payments.
- Report lost or stolen credit cards promptly.
- Protect your identity.



Building a Credit History

- Establish a steady work record and pay all bills promptly.
- Open a checking account and do not bounce checks, learn the correct use of Debit card.
- Keep a savings account and make regular deposits.
- Apply for a local store credit card and make regular monthly payments.
- Apply for a small loan using your savings account as collateral.

Reading a Credit Report

Your Credit Report

Please address all future correspondence to:
Credit Reporting Agency
Business Address
City, State 00000

PERSONAL IDENTIFICATION INFORMATION

Your Name: **SSN #:** 123-45-6789
 123 Current Address **Date of Birth:** July 1, 1968
 City, State 00000 **Telephone Number:** (555) 555-5555

EMPLOYMENT DATE REPORTED

Employer Name: Employer 1 **Position:** Job/Occupation
Date Reported: 06/2004 **Hired:** 04/2004

PUBLIC RECORD INFORMATION

Lien Filed 03/93; Fulton CTY; Case or Other ID Number-32114; Amount-\$26,667
 Class-State; Released 07/93; Verified 07/93

Bankruptcy Filed 12/92; Northern District Ct; Case or Other ID Number-673HC12;
 Liabilities-\$15,787; Personal; Individual; Discharged; Assets-\$780

Satisfied Judgment Filed 07/94; Fulton CTY; Case or Other ID Number-898872; Defendant-
 Consumer; Amount-\$8,884; Plaintiff-ABC Real Estate; Satisfied 03/95; Verified 05/95

COLLECTION AGENCY ACCOUNT INFORMATION

Pro Coll (800)XXX-XXXX
 Collection Reported 05/07; Assigned 09/04 to Pro Coll (800)XXX-XXXX Client-ABC
 Hospital; Amount-\$978; Unpaid; Balance \$978; Date of Last Activity 09/04; Individual
 Account; Account Number 787652JC

CREDIT ACCOUNT INFORMATION

COMPANY NAME	ACCOUNT NUMBER	WHOSE ACCT.	DATE OPENED	MONTHS REVIEWED	DATE OF LAST ACTIVITY	184 CREDIT	TRAILS	BALANCE	PAST DUE	STATUS	DATE REPORTED
Department St.	32514	J	10/96	36	9/08	\$250	X	\$0	X	#1	10/08
Bank	1004735	A	11/96	34	5/08	\$750	X	\$0	X	#1	4/08
Oil Company	541125	A	6/96	12	3/08	\$500	X	\$0	X	O1	4/08
Auto Finance	529778	I	5/96	48	12/07	\$1100	\$50	\$300	\$200	IS	4/08

Previous Payment History: 3 Times 30 days late; 4 Times 60 days late; 2 Times 90+ days late
Previous Status: 01/08 - I2; 02/08 - I3; 03/08 - I4

COMPANIES THAT REQUESTED YOUR CREDIT FILE

09/06/08 Equifax-Disclosure 08/27/08 Department Store
 07/29/08 PRM Bankcard 07/03/08 AM Bankcard
 04/10/08 AR Department Store 12/31/07 Equifax-Disclosure ACIS 123456789

How Much Can You Afford?

Never borrow more than 20% of your yearly net income

- If you earn \$ 400 a month after taxes, then your net income in one year is: $12 \times \$400 = \$4,800$
- Calculate 20% of your annual net income to find your safe debt load: $\$4,800 \times 20\% = \960
- You should never owe more than \$960!

Tips for Managing Your Credit

- Pay off your entire credit card bill every month.
- Stop using it if you can't pay it off.
- Pay on time - avoid late fees.
- Ignore credit card offers.
- Be aware that money borrowed costs money.



Be Smart! Tips

Do

- Pay your bills on time.
- Shop around and ask for advice.
- Take your time.
- Be careful.



Don't

- Respond to pressure tactics.
- Respond to ads making lending sound cheap.
- Don't refinance just after signing a mortgage.