

Credit

This chapter provides an overview of the costs and benefits of using credit, the various sources of credit available to you, and the importance of building good credit.

Credit-
when
someone
provides
you with a
loan that
you must
pay back.

Credit is when someone provides you a loan with the expectation that you will pay back the amount of money you borrowed later. It's important to understand the costs of using credit so you can make good decisions about when and how to use credit. Using credit wisely will help you build a good credit history - which will be very important in helping you build your long-term assets in the future.

Interest: The Cost of Using Credit

Interest-
the
amount
you pay
for the
use of
someone
else's
money

When someone gives you credit or a loan, there is a charge or cost associated with the loan. This charge is called **interest** and it's the amount the person who lends you the credit expects you to pay to use the credit. In Chapter 4, you learned that when you make purchases with your debit card, the money is automatically taken out of your checking account and you only pay for the cost of the item purchased. In contrast, when you make purchases on credit, you pay for the cost of the item and you pay interest for using the lender's credit. As a result, using credit can be costly.

Using credit is costly because you have to pay more than what you would have paid if you had paid for the item in cash. Some types of

credit are more costly than others because in addition to paying interest, some lenders will require you to pay fees and other charges. Remember that when you use credit, you pay more than what you borrow and you have less money to spend on other things. To avoid paying interest, you want to pay your entire balance by the due date.

Opportunity cost- what you may be giving up in the long-term to have something else now.

Another cost of using credit is that it's easy to build up your debt because you may be tempted to buy items that you don't really need. Depending on the amount borrowed and your ability to pay, you'll have to give up buying other things in the future in order to pay off your debt. Therefore, carefully consider the costs of using credit and what you may be giving up in the long-term—this is the **opportunity cost** of using credit.

How Do I Benefit from Using Credit?

There are many benefits to using and having good credit. These benefits include the ability to pay for expenses during emergencies and the flexibility to purchase things when you want or need them and pay for them later. For example, you may be enrolled in a class but may not have the cash to buy your textbooks. Having credit will allow you to buy your books today and pay for them later. Using credit is also safe and convenient because you can make purchases and not have worry about carrying large amounts of cash.



Using credit is also useful because it allows you to establish a credit history and gives you the opportunity to show that you are a responsible and trustworthy individual. When you use credit responsibly, lenders feel more comfortable about giving you additional credit and may even provide that credit at a lower interest rate.

What are the Different Sources of Credit and What Do I Need to Know about Them?

There are a number of credit sources available to meet a variety of needs. These include credit cards, installment loans, student loans, and home mortgages. Each one of these credit sources has specific uses and each has its own benefits and costs.

Credit Cards: How They Work

Have you ever wondered why so many people have credit cards? Credit cards are widely used because they're readily accessible and can be used to purchase just about anything (food, gas, clothes, CDs). There are two types of credit cards: bank credit cards and service or retail credit cards. Bank credit cards can be used in most places where credit cards are accepted. Service or retail credit cards can only be used in specific locations—for example, at a specific department store or gas station.

Bank Credit Cards

- Make purchases wherever credit cards are accepted
- Have high and variable interest rates
- Provide direct access to cash (cash advance) directly from the credit card

Service/Retail Credit Cards

- Used to purchase goods and services at specific locations, such as department stores and gas stations
- Tend to have higher interest rates than bank credit cards
- Don't provide access to cash.

Revolving credit- flexible form of credit.

Credit limit- the maximum amount of money available to you.

Variable interest rates- rates can increase or decrease from month to month.

Credit cards provide a very flexible form of credit also known as **revolving credit**—you have a maximum amount of money or credit available to you (also known as your **credit limit**). You can use your credit at any time and you have the flexibility to decide how much of your balance to pay off each month. Credit card lenders only require that you pay a minimum amount each month, which is helpful during those months when you're short of cash. Once you reach your credit limit however, you'll need to pay off some of your balance in order to continue accessing your credit.



Although credit cards provide a very flexible source of credit, they also likely have high interest rates. As you read earlier, interest is the price you pay for the temporary use of someone else's money. Therefore, if you borrow \$100 for one year and the interest rate is 10 percent per year, you have to repay the \$100 plus \$10 in interest ($\$100 \times 10\% = \10) or \$110 ($\$100 + \10). Credit cards also tend to have **variable interest rates**—rates can increase over time. Below is an example of how using credit affects the total cost of your purchase.

Michael wants to buy a new coat that costs \$100. What are his options? He can buy the coat and pay for it right away using cash or his checking account (writing a check or using his debit card) or he can use his credit card, which carries an interest rate of 14%. As you can see from the table below, the credit card purchase is more expensive.

	CASH	CREDIT
INITIAL COST	\$100.00	\$100.00
INTEREST RATE	None	14%
INTEREST CHARGES	\$0	\$14.00
FINAL COST	\$100.00	\$114.00

You should also be aware that the longer it takes you to pay off the balance on your credit card, the more you'll pay in interest and other charges. To avoid paying more, try to pay off your balance each month. This way, you pay less in interest charges and you have access to your credit when you really need it.

Installment Loans

Installment loans are long-term loans that must be paid off within a specified period of time (usually 48 to 60 months). You make regular payments each month until the loan is paid off. The lender uses the length of the **loan term** (how long it will take you to pay off the loan) and the interest rate to determine your monthly payments. The longer the loan term, the smaller the monthly payment but the more interest you pay and the greater the cost of the credit.

Loan term- how long it will take you to pay off the loan.

Fixed- the rate remains the same throughout the length of the loan.

You generally can obtain an installment loan to make a large purchase, such as buying a car or a computer. You can apply for installment loans at car dealerships (to buy a car), banks or credit unions. Because the loan is used for a specific purpose, the amount of the loan is **fixed**—it remains the same throughout the life of the loan—and depends on the cost of the item to be purchased. Installment loans usually carry a fixed interest rate that is typically lower than credit card interest rates.

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Michael needs to buy a car. He saw a used car for \$2,500. The lender has asked him to decide on the term of the loan (how much time does he need to pay off the loan). Can you help him decide?

	LOAN A	LOAN B
LOAN AMOUNT	\$2,500	\$2,500
INTEREST RATE	9.00%	10.00%
LOAN TERM	48 MONTHS	60 MONTHS
MONTHLY PAYMENT	\$62.21	\$53.12
TOTAL COST	\$2,986.08	\$3,187.06
TOTAL INTEREST PAID	\$486.08	\$687.06

Michael can pay off the loan in 4 or 5 years. Is it worth it for Michael to take more or less time to pay off the loan? Why or why not?

Consumer laws require that lenders provide you with the terms of the loan in writing. You should read these terms carefully before signing a loan agreement. As with any other loan or credit, you should shop around to get the best possible offer. For example, if you are interested in buying a car, do not simply rely on loan offers and advertisements from car dealerships but also consider talking to your local bank or credit union about their loan offers. They may provide you with better loan terms.

Student Loans

If you plan to go to college or take training courses, you'll most likely need a student loan to help pay for your education. There are a number of student loans available through banks, credit unions and the federal government. These loans can be used to pay for your tuition, room and board, books and any other expenses related to your education.

Federal student loans are particularly valuable because they tend to have lower interest rates than student loans from other financial institutions—interest rates don't typically exceed 8.25%.

Depending on your bank and the loan you take out, you may be able to postpone or defer making payments on your student loan until after you



graduate or complete your education program. Once you have completed your education program, it's very important that you make your student loan payments regularly and on time. If you're having problems making your payments, contact your loan officer or

financial institution. You may be able to develop a plan to either postpone or reduce your payments for a period of time. If you don't make your student loan payments, this information will go on your credit report and will affect your ability to access credit in the future.

Mortgages: Building Your Longer-Term Assets

A mortgage is a long-term loan that allows you to buy real estate property, such as a condo, townhouse, or house. The amount of the loan mortgage is usually fixed and based on the cost of the property. The term of the loan is typically between 15 and 30 years. Some people choose a 30-year loan term because it allows them to make lower monthly payments. However, these loans usually have higher interest rates. As the example below shows, however, the downside to a longer loan term is that in the end, the total cost of the loan is significantly greater because of the interest charges you pay.

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COSTS FOR A \$50,000 FIXED-RATE MORTGAGE	15-YEAR AT 7.00%	30-YEAR AT 7.50%
MONTHLY PAYMENT	\$449	\$333
INTEREST PAID DURING FIRST 5 YEARS	\$15,671	\$17,025
INTEREST PAID OVER FULL TERM OF MORTGAGE	\$30,895	\$69,754
TOTAL COST OF THE LOAN	\$80,895	\$119,754

Down payment- a large upfront payment.

Repossess- when the lender takes back the property to sell it because you don't make the payments on the loan.

Most lenders require you to make a large payment upfront called a **down payment** in order to qualify for a mortgage loan. But there are also programs available with smaller down payment requirements. Mortgage loans are considered secured loans because the purchased item (house) is used as security or collateral on the loan. In other words, if the borrower stops making the mortgage payments, the lender can take back the property or **repossess** it and sell it for cash in order to settle the loan.

Credit Sources and Their Characteristics

Type	Uses	Interest Rates	Term (Length)	Payment
Credit cards	Small purchases, Emergencies	Variable	Short-term	Varied (minimum payment)
Installment Loans	Large purchases	Fixed	Long-term	Set payment/amount
Student Loans	Educational expenses	Fixed	Short and long-term	Set payment/amount (can be deferred or postponed)
Mortgage	Real estate property	Fixed	Long-term	Set payment/amount

Other Credit Sources

You should also be aware of—and try to avoid—other more expensive and less reliable sources of credit, including payday-lending and rent-to-own. You've probably seen ads or commercials on television for these companies and have heard about them on the radio.

- **Payday lending** is used by people who need immediate access to cash. This type of credit involves borrowing money with the intention to pay it back within a certain amount of time—for instance, at the time of the borrower's next paycheck. Payday lenders charge very high fees on their loans that translate to very high annual interest rates. The lender always keeps the fee charged for the loan and at the time of repayment, the borrower must pay the entire loan plus the fee. If unable to pay the loan in full by the due date, the borrower must pay an additional fee to keep the loan.
- **Rent-to-own** is when you rent an item that you would like to use for a specific period of time and you agree to make monthly or weekly payments while you use the item. You can also choose to buy the item and continue to make payments until the item is paid off. If you fail to make a payment, however, the lender will take

back the item and you'll lose the money paid. This credit option is costly because you don't own the item while you use it and if you don't make your payments on time, you lose all the cash you have invested in the item.

Consumer protection laws- laws that protect a person's rights.

Payday lending and rent-to-own services aren't regulated by the government and don't have to follow [consumer protection laws](#). These lenders aren't monitored by any agency and have no incentive to share information with you about the terms of their credit. Because they are expensive and unreliable, try to avoid these sources of credit.

Comparing Credit Sources: What's My Best Option?

Because there are many sources of credit available to you, it's important to compare credit sources to determine which is the best option. Comparing credit sources will require some homework on your part but in the long run, it will not only help you save more but also will help you meet your financial goals. A wise consumer shops around and compares all credit sources in order to get the best value for their money.

Some of the things to consider when comparing credit sources include: interest rates, minimum monthly payments, fees and penalties and grace periods. This shouldn't be a difficult task to accomplish because lenders must make this information readily available to you. But, you have to know this information and you should always read the fine print before signing a credit offer.

The Basics of Interest Rates

The interest rate is the amount lenders charge you to use their credit. The higher the interest rate, the more it will cost you to use the lender's credit. Lenders use introductory rates and annual interest rates (also known as annual percentage rate). Interest rates can be fixed (they remain the same over the life of the loan) or variable (they can increase or decrease).

Introductory rate- the initial rate the lender will charge you to use the credit.

Annual percentage rate- amount you will pay each year to use the credit.

Finance charge- the money you pay to use credit each month.

- The **introductory rate** is the initial rate the lender will charge you to use the credit. This rate may or may not remain the same throughout the life of the loan. You should beware of credit offers with low introductory rates because interest rates tend to increase over time. You should read all credit offers very carefully so that you are clear about the introductory rate, when the rate is likely to change and what new rate will be applied to your credit.
- The **annual percentage rate (APR)** is the amount you'll pay each year shown as a rate or a percentage, to use the credit. The APR includes the rate of interest, transaction fees and any other service charges related to the use of the credit. You should seek sources of credit with low APRs. For instance, if you have a credit card and plan to keep a balance on your account, you should look for a card with a low APR to minimize the amount you'll have to pay in interest each year. Lenders use the balance on your account and the APR to calculate the dollar amount you'll pay to use the credit each month. This amount is called a **finance charge**. You'll see these charges reflected on your monthly credit statement.



Minimum Monthly Payment: Is It a Good or a Bad Thing?

The minimum monthly payment is the amount a lender expects you to pay to keep your account in good standing. The minimum monthly payment is a small percentage of your balance (typically 2%) and decreases as your balances decreases. If you only make the minimum monthly payment, it will take you longer to pay off your debt. The longer it takes you to pay off your debt, the more you'll pay in interest and the higher the profit for the lender.

Michael needs to buy a computer that costs \$1500. He uses a credit card that carries an 18 percent interest rate to buy his computer. When he receives his first bill, he realizes that he only has to pay \$30 towards his credit card bill. Michael is happy about this because he does not have much money left from his paycheck.



As the table below shows, if Michael pays the minimum amount every month (the minimum starts at \$30 and decreases with each of his monthly payments), at the end of the first year, he will have only paid **\$87.57 towards his balance and \$262.69 in interest charges**. At this rate, it will take him more than **27 years** to get rid of his debt and in that time, he will pay **\$3,431.11** in interest!

CREDIT CARD				
18% APR			BALANCE: \$1,500	
PAYMENT SCHEDULE				
MONTH	MINIMUM PAYMENT	INTEREST PAID	PRINCIPLE PAID	REMAINING BALANCE
1	\$30.00	\$22.50	\$7.50	\$1,492.50
2	\$29.85	\$22.39	\$7.46	\$1,485.04
3	\$29.70	\$22.28	\$7.43	\$1,477.61
4	\$29.55	\$22.16	\$7.39	\$1,470.22
5	\$29.40	\$22.05	\$7.35	\$1,462.87
6	\$29.26	\$21.94	\$7.31	\$1,455.56
7	\$29.11	\$21.83	\$7.28	\$1,448.28
8	\$28.97	\$21.72	\$7.24	\$1,441.04
9	\$28.82	\$21.62	\$7.21	\$1,433.83
10	\$28.68	\$21.51	\$7.17	\$1,426.67
11	\$28.53	\$21.40	\$7.13	\$1,419.53
12	\$28.39	\$21.29	\$7.10	\$1,412.43
		\$262.69	\$87.57	\$1,412.43

Total Paid at the End of Year 1 →

Grace Period

The grace period is the amount of time (usually 21 days) a lender gives you to pay the entire balance on your account without charging you interest or finance charges. If you don't pay your bill before the end of the grace period, you'll pay more for the use of the credit than you would have otherwise. Some credit cards don't have a grace period or have a shorter grace period and if you don't pay off your balance each month, you'll be charged at a very high interest rate.

You should carefully review and fully understand the terms of the loan or credit before signing a credit agreement. For instance, because fees

vary substantially from lender to lender, it's important to know the terms of your loan or credit. Just as important, however, is avoiding late payment fees that will reflect negatively on your credit report and taking advantage of the grace period to avoid paying interest or finance charges.

Other Fees

In addition to the APR, there are also fees and penalties that lenders can add to your credit or loan. These include: late payment fees, annual fees, and over-the-credit limit fees.

Late payment fee- a charge for any payment received past the due date.

Annual fee- a yearly charge for using their credit.

Over-the-credit limit fee- a fee for going over your credit limit.

- Most lenders will charge you a **late payment fee** for any payments received past the due date.
- Some lenders will expect you to pay an **annual fee** for using their credit—some lenders will waive the annual fee for borrowers with a good credit record.
- Credit card companies will charge you an **over-the-credit limit fee** if you go over your credit limit.

You should also know that some lenders will charge you a fee if you pay the balance of your loan or credit early—this typically applies to installment loans and home mortgages. For these lenders, an early payment means they make less money and charging this fee is one way to make up the loss.



Important Questions to Ask When Comparing Credit Sources

- What is the introductory interest rate and when does the rate end?
- What is the annual percentage rate?
- For credit cards, is there a different interest rate for cash advances? Is there an extra charge for cash advances?
- What fees will I have to pay to use this credit card?

What are Credit Reports?

To access any of the sources of credit described above, you'll need to show that you have the ability and the reputation of someone who's willing and able to pay for credit. Lenders obtain this information from your credit record.

Credit Record

Your credit record is a picture of your credit history and your debt. It tells current and potential lenders about your level of credit "worthiness" and "responsibility". Your credit report is created by credit reporting agencies with information they collect from lenders. For example, the information in your credit report includes how many credit accounts you have, what assets you own (whether you own a car or home), whether you pay your bills on time and whether you have ever declared **bankruptcy** (a legal process that allows you to develop a plan to get out of debt). Credit reporting agencies sell the information in your credit report to lenders, employers, and others who want to know how you handle money and how you manage your debt.



Credit report- a legal document that shows how much debt you have and whether you pay your bills on time.

Bankruptcy- a legal process that allows you to develop a plan to get out of debt.

Credit Scores

Credit score- points that you are awarded based on your credit record that tells lenders about your credit

Your credit report includes **credit scores** that tell lenders about your credit worthiness. These scores are determined by a number of factors, including:

- Payment history—did you pay your bills consistently and on time? Have you filed bankruptcy or had any **collections**?
- Outstanding debt—how many accounts do you have with balances and how much do you owe on all accounts? What types of credit do you have and how much credit is available on all accounts?
- Credit history—how long have you had credit and how long have you had each account?
- New credit—how many new accounts have you opened and how much time has passed between opening the accounts?

Collections- when a collector has to remind you to pay your debt.

These factors determine your overall credit score, which allows lenders to determine whether you're a risky borrower and whether credit should be made available to you. Maintaining good credit has its rewards: it gives you access to loans and credit when you need them, it allows lenders to give you credit at lower interest rates (which makes credit less costly for you) and will allow you to increase your assets.

How Do I Obtain My Credit Report?

There are three credit reporting agencies or companies (Equifax, Experian and TransUnion) that collect information from lenders to create your credit report. The agencies are different and may collect different information from different lenders. Because the information in your credit report will determine your ability to access credit, you should review your credit report at least once a



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year to know what it contains and to correct any errors that may appear in your credit report.

To ensure the accuracy of your credit report, you should obtain and review your credit report from each of these companies. This is particularly important because lenders might not report or share their information with all three reporting agencies. You can request a copy of your credit report by writing a letter or calling the companies. Write to them or call them using the address and phone number listed here:

1. Equifax
Credit Information Services, Inc
P.O. Box 740241, Atlanta, GA 30374
1-800-685-1111

2. Experian
National Consumer Assistance Center
P.O. Box 2104, Allen, TX 75013
888-397-3742

3. TransUnion
Consumer Disclosure Center
P.O. Box 1000, Chester, PA 19022
1-800-888-4213

Or, you can complete a credit report request form online. The agency websites are listed below along with the steps to obtaining your credit report online.

Equifax: <http://www.equifax.com>

Experian: <http://www.experian.com>

TransUnion: <http://www.transunion.com>

Steps to obtaining your credit report online

1. Visit Equifax at:
<http://www.equifax.com>
2. Complete the order form by providing:
 - Your Name
 - Date of Birth
 - Gender
 - Social Security Number
 - Address
 - Telephone Number
 - Email Address
3. Accept the terms of use of the service
4. Provide your credit card information for payment

At the moment, you have to pay a small fee (\$9 or more) each time you request a copy of your credit report, but the federal government passed a new law that will soon allow you to obtain a free copy of your credit report once a year. There are also times when you can obtain a free copy of your credit report—for example, when you have been denied credit, a job, insurance, or rental housing because of information included in your credit report. Contact the credit reporting agencies within 60 days of being denied credit, a job, insurance, or housing to receive a free copy of your credit report.

You can also obtain a free copy of your credit report once a year if you're unemployed or receiving public assistance. You'll have to contact the agencies by phone or mail and be able to proof that you qualify for a free copy of your credit report. Reviewing your credit report will allow you to determine why you have been denied credit, a job, or other opportunity.

Correcting Errors in Your Credit Report

If you identify errors in your credit report, you'll have to go through a long and sometimes difficult process of contacting the credit-reporting agency to have the information removed from your credit report. This can be a difficult process because the credit-reporting agency will not remove information on your credit report unless asked to do so by the company or organization that provided the information. Therefore, you'll probably need to get in touch with the company or organization to begin to address the issue. Although you can contact them by phone, you also should write formal letters requesting that they fix the error. You should always document the date of all telephone conversations, the person you spoke with, and topic of the discussion. You should also keep copies of all your correspondences and submit copies of letters and other documents to the credit-reporting agency, along with a copy of your credit report.

In addition to obtaining your credit report from the three credit reporting agencies listed above, you also can obtain a FICO score report which will provide you with your credit score for all three credit agencies. The FICO report also tells you what specific factors affect your credit score and what you can do to improve these factors. Knowing your credit score and the factors that affect your score can be an important step towards cleaning your credit report. You can obtain your FICO score online by visiting the following website: <http://www.myfico.com>.

Your credit report and credit score are not the only factors lenders use when deciding whether or not to give you credit. Remember that banks and credit unions provide information about individuals who have a history of mishandling their checking and savings account—for example, people whose accounts were overdrawn and then closed—to consumer reporting agencies. This information is compiled in consumer reports, is available to other banks and credit unions and can prevent you from opening future checking or savings account. If you've mishandled your checking or savings account in the past because of bounced checks and insufficient funds, talk to your financial institution to develop a plan to address these issues.

Developing a plan to correct errors on your credit report or other credit problems will put you on the road to your long-term financial success.

In general, you should keep in mind that a poor credit or banking history will make it very difficult for you to accumulate assets. Therefore, it's very important that you check your credit once a year and take the necessary steps to clean up your credit report or your banking history as soon as possible.

Information on your credit report

1. *Your personal information*
(name, address, telephone number, employment history, spouse's name)
2. *Credit information* (types of accounts, open and closed accounts, accounts in good standing, negative account history)
3. *Inquiries* (by lenders who want to know your credit history and inquiries initiated by you each time you apply for credit)
4. *Collections and public records*
(unpaid bills referred to collection agencies and bankruptcy filings)
5. *Dispute File Information* (any statement you provide the credit bureau to clarify information on your credit report)

Knowing Your Consumer Rights

The federal government has created laws that protect your rights as a credit consumer and it's important to be aware of these laws. For example, as a consumer you have the right to obtain credit, as long as you are "credit worthy", and you have the right to know how much it will cost you to obtain credit.

Specifically, the following laws protect your consumer rights: Equal Credit Opportunity Act, Truth in Lending Act and the Fair Credit Reporting Act (FCRA).

- The **Equal Credit Opportunity Act** prevents lenders from discriminating against consumers.
 - You shouldn't be denied credit based on your race, color, national origin, religion, sex, marital status, age, or receipt of public assistance.
 - Lenders cannot require you to provide information about your race, nationality, sex, marital status, or receipt of public assistance.
- The **Truth in Lending Act**, also known as the Consumer Credit Protection Act, was developed to allow consumers to shop around and make comparisons when applying for credit.
 - Lenders are required to tell you in writing the total costs of using their credit—for example, the interest rates, fees, and finance charges of the credit.
 - If you apply for credit, but change your mind, the Truth in Lending Act gives you the right to cancel certain types of credit within three days of application.
 - If your credit card is stolen and used without your permission, credit card companies cannot charge you more than \$50 when someone else uses your card.
- The **Fair Credit Reporting Act** allows you to access your personal credit history and requires that credit reporting

agencies investigate and remove any errors in your credit report.

- Lenders must notify you if you have been denied credit as a result of information included in your credit report and provide you with a free copy of your credit report within 60 days of the notification.

It's very important for you to know and understand your rights as a consumer. Because of these laws, you have the power to accept and reject any credit offer and to get answers to the questions that will you make the decision that works best for you. Therefore, don't give up your rights!

How to Maintain Good Credit

As you can see, there are many benefits to having and maintaining good credit. To maintain good credit, follow these basic steps.

1. Pay your bills regularly (every month) and on time;
2. Keep the amount owed on your accounts to a minimum by paying off the entire balance on your credit card every month or paying more than the minimum monthly payment;
3. Avoid applying for many credit cards (having too many credit accounts);
4. Try to use one credit card only so that it's easier to track your expenditures;



5. Contact your lender if you're having problems paying your bills and try to establish a plan to continue making your payments; and
6. Close any credit account you don't use. For example, if you apply for a JC Penney's card but you don't use it, don't just cut up the card but also close the account by calling the lender.

Tips to Manage your Debt

To meet your long-term goals and your financial plans, it's important to be a responsible borrower and manage your debt efficiently. Following are some tips to avoid excessive debt:

- Use the budget you developed in Chapter 3 to know what you can afford. Only borrow what you can afford to pay.
- Pay your bills on time to avoid any fees, charges or other penalties for late payment;
- When paying your bills, pay more than the required minimum balance to keep down the cost of what you borrow (pay as much of your debt as possible);
- Choose lenders that provide you with the lowest interest rates and minimal fees;
- Pay all your bills but pay a higher portion (greater amount) of those bills with the highest interest rates and fees; and
- When possible, use your debit card or checks to pay for the items you want to buy.

Although it's your responsibility to manage your debt—and to avoid getting into debt—you can also seek assistance from others if you have problems managing your debt. For example, there are nonprofit credit-counseling organizations that can work with you to

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help you develop a plan to repay your debt. Many of these services are available to you at no cost. You can also seek assistance from an adult you trust and from organizations in your community that provide credit-counseling services.

If you follow these tips, you'll be able to use and manage your credit effectively. Although managing your credit takes time and effort, building a good credit record is very important to your financial future. Establishing good credit will help you build your assets and meet your long-term goals.

Credit Glossary

Annual Fee: A yearly charge for using credit.

Annual Percentage Rate: The amount of interest you will pay each year.

Bankruptcy: A legal process that allows you to develop a plan to get out of debt.

Cash advance: The process of getting cash from your credit limit: either using an ATM, credit card or using checks issued by the lender.

Collections: When a collector has to remind you to pay your debt.

Consumer protection laws: Laws that protect a person's rights and prevent businesses or organizations from violating those rights.

Credit: A loan that you have to pay back and that allows you to buy something today and pay for it later.

Credit limit: The amount of money that is available for you to spend using credit.

Credit record: A record or picture of all the loans you have had and your payment history.

Credit reporting agency or credit bureau: Company that collects information from lenders about your credit history and uses the information to create your credit report.

Credit report: A legal document that shows how much debt you have and whether you pay your debt on time.

Credit score: Points that you are awarded based on your credit record and that appear on your credit report and tell lenders about your credit history. The higher the credit score, the better your credit history.

Down payment: An amount of money you pay upfront in order to qualify for a mortgage.

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Finance charge: The amount of interest you pay every month for the use of the credit, calculated by a formula that includes the APR and the balance on your account.

Fixed: A constant or unchanging amount or rate.

Interest charges: The amount of interest due on the credit, which is added to your credit amount.

Introductory rate: The initial rate you are charged for using credit.

Late payment fee: A charge or penalty that a lender adds to your balance if you do not make your payments on time.

Lender: A person or company that lets you borrow money.

Loan term: The length of the loan or credit (e.g., 4 or 5 years).

Opportunity cost: What you may be giving up in the long term to have something now.

Over-the-credit limit fee: A fee lenders charge when you spend more than your credit limit.

Payday lending: A type of credit that provides access to small loans at a very high cost.

Rent-to-own: A type of credit that charges you a high fee to rent and use an item that you want but cannot afford to buy.

Repossess: Take back or reclaim. For example, a lender will repossess a home when the buyer cannot make the mortgage payments.

Revolving credit: A maximum amount of credit available to you for your use as long as you do not go over the amount of credit and the account remains in good standing.

Secured loan: A secure loan is a loan that gives the lender greater security (i.e., less risk) because if the loan is not repaid, the lender can take back the borrower's property.

Student loans: Loans used to pay for educational expenses.

Variable interest rates: Rates that can increase or decrease from month to month.