CREDIT BASICS

Before we can speak intelligently about credit, there are a few terms with which you must become familiar (use transparency on preceeding page).

1. Interest: Cost of credit.
2. Collateral: Security on a loan.
3. Cosigner: Second signer who will pay for the loan if the first party defaults.
4. Default: Failure to repay the loan.
5. Bankruptcy: Legally getting out of having to repay debts; destroys credit rating for seven years; admitting and accepting financial failure.
6. Garnishment: Your employer pays your creditor before you receive your pay. (Not a good way to impress employers!)
7. Credit: Allows the immediate use of products or services in exchange for a promise to pay in the future.
8. Annual Percentage Rate (APR): The cost of a loan over a full year expressed as a percentage.
9. Credit Rating: a rating based on how promptly a person pays his/her debts.

TYPES OF CREDIT

Many types of credit arrangements are available. Some of the common arrangements have been classified here under three main headings to help acquaint you with various credit options. These three main types are: sales, cash, and service.

I. Sales Credit—Sales credit is credit you receive when you make a purchase now and promise to pay later.

   A. Installment Plan—Payments to the store are made in equal amounts over a period of weeks or months. A down payment is often required. Many people use this plan to buy things that are expensive. The store can take back what you are buying if you do not make the payments. This type of credit is usually used for big things, like a washing machine, television, or furniture.

   B. Charge Accounts—Many stores offer charge accounts. The store may tell you how much you can charge. Sometimes no limit is set. You usually get a bill each month telling how much you owe. Credit cards are given with many charge accounts.

      1. Open Charge Account—There are different types of charge accounts. One kind is the open charge account. With this kind of charge account, you must pay the entire amount when you get the bill. You pay no interest on this kind of account if bills are paid on time. Example: American Express.

2. Divided Charge Account—The divided charge account, sometimes called a 90-day account, lets you pay for an expensive item in three equal monthly payments. Usually no extra charge is added.
3. Budget Account—With budget accounts, sometimes called "easy payment plans," you must pay a certain amount each month, as long as you owe at least that much. If you owe less, you pay only what you owe. You pay interest on what you owe.
4. Revolving Credit—Still another kind of charge account is called revolving credit. The amount is a certain percentage of what you owe. You pay interest on what you owe.

C. Credit Cards—Credit cards are also a type of sales credit. They are similar to installment plans. They are convenient to use when you don't want to carry much cash. Types of credit cards include "Single Purpose," "Travel and Entertainment," and "Bank Credit Cards."

II. Cash Credit—Cash credit is credit you receive when you borrow cash and pay it back later.

A. Personal Loans—Personal loans may be either installment or single-payment loans. They are particularly useful when you need cash to meet an unforeseen emergency or to help your family through a period of unexpected financial stress. A personal loan can help pay rent, buy food, and meet medical expenses when the head of the household is temporarily out of work or some member of the family is seriously ill.

1. Term or Single-Payment Loan—Repayment and interest on the loan are due in one lump sum 30, 60, 90, or 120 days from the date of securing the loan.
2. Installment Loan—Periodic payments (usually monthly) of principal and interest on the loan can be made over a three- to 36-month period.
3. Checking Account with Overdraft—The consumer arranges a credit limit with a bank—$300, $500—etc., which is available to be drawn against and allows the consumer to write a check for money he/she does not actually have on deposit. As the consumer draws from the overdraft part of this account, the checking account is credited with enough money to cover the overdraft. This money is then treated in a manner similar to a bank loan and the consumer is billed for the overdraft.

III. Service Credit—Credit given for a service one's family receives and pays for later is called service credit. You use service credit when you make monthly payments for utilities you have used during the month (telephone [not pay-telephone], gas, electricity). You also use service credit when you pay your doctor, dentist, or hospital at the end of the month.

ADVANTAGES AND DISADVANTAGES OF USING CREDIT

Advantages of credit:

1. Maintains a healthy economy. Our economic system is built on credit and without the means of buying now and paying later, the economy would collapse. An example is the stock market.
2. Allows us to meet emergencies.
3. Convenient—easier to order over the phone.
4. Permits purchase on sales or when the price is down.
5. Able to enjoy an item while paying for it and raise your standard of living.
6. Establish a credit rating.
7. Might receive advance notice of sales.
8. Find it easier to exchange and return items.
9. Detailed monthly bill.

Disadvantages of credit:

1. Credit always costs money.
2. Creates risk because you are spending your future income.
3. Increases the cost of doing business.
4. Encourages careless buying.
5. Facilitates over-buying which increases sacrifice that must be made eventually.
6. Often increases family conflict.

Things to remember on sales contracts:

1. Read and understand the contract. Watch for standard terms.
2. Be sure all spaces are completed.
3. Be sure the APR is the same as the salesperson stated.
4. Be sure the last payment is the same as the others. Avoid balloon payments because as time passes the payments become exorbitant.
5. Be sure the salesperson gives you a copy of the agreement.
6. Insist on no penalty for early payment.

Places to borrow:

1. Commercial bank
2. Savings and loan
3. Mutual savings bank
4. Credit unions
5. Licensed loan or financial company
6. Cash value on life insurance

7. Family and friends
8. Cash advance on credit cards
9. Pawn broker

How to compute the maximum credit you should use:
1. The total should not exceed 20% of one year's net income.
2. The installment debt (monthly payments) should total no more than 1/3 of your annual net income that is left after you take care of food, clothing and fixed expenses.

CREDIT RATINGS:
If you have had credit before, your credit rating is based upon how promptly you have paid your debts. If you have not credit record, other factors will be considered: employment, your student or job status, your assets (savings account, car, etc.)

If you are rejected for credit, you should check your credit report to see what the problem is. The credit bureau must show you your file. If you can prove that any negative information is incorrect, everyone who received the bad report in the past six months will get a corrected report at your request.

It may be difficult to establish a credit rating when you have never had credit. Here are some ideas to help you get credit the first time:
1. Have checking and savings accounts and manage them responsibly. Sometimes savings can be used as collateral for a loan.
2. Use the layaway plans at local stores. This is a type of credit where the store keeps the item you are purchasing until you have paid for it. If you can successfully complete this type of credit, you may be eligible for a charge account.
3. Ask a merchant who knows you well to give you a line of credit. Be sure to start with small amounts and repay promptly.
4. Many stores offer special teenage accounts if their parents have an account at the store.
5. Make a big down payment. Lenders are more willing to let you make installment payments if you pay a large amount up front.
6. Get a cosigner for a loan (parent, relative, or other adult).