OHIO STATE UNIVERSITY EXTENSION

A SIX LESSON SERIES

MANAGE YOUR MONEY

Lesson 4: *To Your Credit*

THE OHIO STATE UNIVERSITY

MANAGE YOUR MONEY

Lesson 4

This lesson uses Worksheet J and K and Activities 4-1 and 4-2

To Your Credit

Credit is the reputation a person earns as they manage their money and other resources. Credit holds the expectation of paying the lender back with the borrower's future income. If a person has a history of mismanaging money (for example, not paying bills on time or as agreed), they have "bad" credit and may have a tough time getting a loan, renting a place to live, or getting a credit card with a reasonable interest rate and terms. On the other hand, a person who regularly pays their bills on time has built a "good" credit history and can buy the goods and services they want now with someone else's money. Credit is the direct reflection of your ability to borrow money for things you want and need. But the privilege of using credit comes with a price. The amount you pay the lender will normally be more than the amount you borrowed. This additional cost is in the form of interest and fees passed on to you, the borrower.

Interest paid is the cost of using someone else's money until you actually send your own money to pay for what you bought. The amount of money you pay in interest is the cost of using those goods or services without paying at the time you get them. If you pay the lender back as you agreed when you accepted the line of credit, they are happy to offer you more credit in the future. If you don't pay them back when you said you would, or don't pay them back at all, they will want to charge you a higher interest rate and fees to extend credit to you in the future.

The most common credit sources include banks, credit unions, and finance companies. In addition,

if you purchase an expensive item from a furniture or appliance store, or from a car dealership, the retailer will often offer the use of credit.

Pawnshops, payday or check cashing lenders, car titles lenders, and rapid-refund services are some of the "alternative lenders" in the business of making money by lending. Borrowing from any of these, however, is commonly the worst way to borrow because their terms, fees, and interest rates are designed so that they keep making money off your on-going spiral of debt.

Insurance policyholders who have a cash-value life insurance policy can normally obtain loans based on the cash value built up in the policy. Home owners can often secure home-equity loans from their mortgage lender. Equity in your home is the amount of money you already paid back to the bank. You can borrow this money, essentially borrow it from yourself, in order to use it for current expenses. In addition, under certain circumstances, people may be able to tap their retirement accounts with the intent to replace the money at a later date.

When used wisely, credit can be a valuable financial tool. It is often more convenient and can be more secure to use than cash. Credit also offers some valuable consumer protections. However, when used carelessly, credit can cause serious financial problems. You could owe more than you can repay and end up spending a great deal more than expected due to on-going monthly interest and fees. You could damage your financial reputation (lower your credit score), resulting in higher interest rates, stricter terms, and lower credit limits. Or, if you have agreed to a secured loan, you could lose your property.

Types of Credit

There are two basic types of non-mortgage consumer credit: closed-end and open-end.

- **Closed-end credit** is extended for a specified amount of money over a set time period. No further purchases or loans can be added to the original amount, hence the name "closed." The payment period, payment amount, and the number of payments remain fixed for the life of the credit agreement. An installment loan for purchasing a car is a good example of closed-end credit. Other examples include loans for high-cost items such as major appliances and home improvements.

Most closed-end credit purchases are secured debts – whatever is purchased can be taken back if you do not pay as agreed.

- **Open-end credit** allows you to make repeated purchases or obtain cash up to a specified limit from an ongoing agreement with the creditor. Some agreements require payment of the full balance each month. Other agreements allow a monthly minimum payment with a finance charge on any balance not paid. Examples of open-end credit include bank issued credit cards, retailer sponsored credit cards that limit use solely to their stores, checking accounts with overdraft privileges, and home equity lines of credit.

Beware of Rent-to-Own

Buying items with a rent-to-own option is another method of getting what you want using credit, but you will pay far more than using traditional methods. The price tag for the merchandise will usually be more, the interest charged will be higher, and you will pay a variety of fees. Rent-to-Own also includes the possibility of having the items taken back if not paid as agree and this will damage your credit reputation.

Except for a home equity line of credit, most open-end credit is unsecured - there is no collateral to seize if you do not pay. This is why the interest rates are normally higher than closed-end credit.

Common Sources of Consumer Credit

Multi-purpose Credit Cards: Multi-purpose credit cards provide open-end credit that is widely accepted at thousands of businesses worldwide. These credit cards normally have a set credit limit and, usually, monthly billing. They are most commonly issued by financial institutions such as banks. Credit unions and large consumer-product companies also issue credit cards. The credit card issuer will work directly with the card-holder (you) to service the account. However, account terms and use policies are established by a card network such as Visa, MasterCard, American Express, and Discover - the four largest credit card networks. They process credit card transactions and act as the conduit between merchants and the financial institution that issued the card.

Single-purpose Credit Cards: Offered by department stores, gasoline companies and other retail stores, a single-purpose credit card can be used only to purchase items at the issuing business.

Home Equity Line of Credit: The difference between the appraised market value of your home and any mortgage debt owed is the equity that you have in your property. Some financial institutions will offer a "home equity line of credit (HELOC). A HELOC will allow you to borrow your own money as needed. There is a set amount available and a time period established by the lender. Like a credit card, your credit revolves and you can use it again as you pay on the HELOC.

Advantages of Credit

- Credit allows you to buy things you need that you cannot afford to pay for immediately in cash. Examples include buying a house or a car.
- Credit cards are convenient to use and safer than carrying large amounts of cash.
- Credit cards make it possible, easier, and safer to order merchandise and make reservations online or by phone.
- Services such as renting an automobile, purchasing airline tickets, or obtaining hotel accommodations are difficult without a credit card.
- Credit card programs offer perks such as air miles, rebates, or bonus points for use of the card.
- It may be possible to buy some goods at a lower price now than in the future. For example, if you plan to buy a refrigerator and it goes on sale, using credit might allow you to buy the refrigerator at a lower price than if you saved the cash and then had to pay full price.
- Interest costs for mortgages and home equity loans may be tax deductible if you itemize deductions on your income tax return.

Disadvantages of Credit

- You may be tempted to buy more than you need because it is easy to put the cost on your credit card.
- You may be tempted to shop only at stores where you have a store credit card instead of comparison shopping for the best price at a variety of stores.
- Buying on credit can be habit forming and, if not paid off in full every month, can add 20 percent or more in interest and fees to the cost of goods and services.
- Cards that offer air miles, rebates, or bonus points frequently charge a fee for the card and charge a higher interest rate. These reward programs require organizational skills to keep track of how to redeem points and rewards.
- You may be charged additional fees such as late payment fees, over the limit fees, or an annual usage fee for a credit card.

If you are considering applying for a credit card, **Worksheet J: Choosing a Credit Card**, at the end of this lesson will be helpful.

Credit History

Lenders need to see evidence that you are able and willing to pay them back before they will welcome you as a customer. The evidence they use is called your credit history, which is summarized in a multi-page credit report. The companies that gather and sell this type of information are called credit bureaus. Each of the three major credit bureaus uses financial information regarding your borrowing history to assign individuals a credit score. The most common credit score is a three-digit FICO score.

If you have financed a car or made some other purchase using credit, your loan and payment information is likely recorded at a credit bureau. The more prompt and reliable you have been in paying bills and making regular payments, the better your credit history and the higher your credit score.

Before applying for credit, it is a good idea to obtain a copy of your credit report. You can obtain a free copy of your credit report once per year from each of the three major credit bureaus. Therefore, consider requesting a report from one credit bureau and waiting at least four months to request a report from a different credit bureau. The authorized website for free credit reports is detailed in the box below. You will need to provide your name, address, social security number, and date of birth to verify your identity. You may be asked for additional information or proof of identity.

If you were denied credit, insurance, or employment due to information in your credit file, be sure to include a copy of the letter telling you this.

Obtain your free credit report from the Annual Credit Report Request Service:

Online:

- ***annualcreditreport.com***

Phone:

- Call 877-322-8228
- You will go through a verification process over the phone.
- Your credit report should be mailed to you within 15 days

Mail:

- Fill out the request form at the end of this lesson or download the request form at this link: ***annualcreditreport.com/manualRequestForm.action***
- Mail the completed form to: Annual Credit Report Request Service, P.O. Box 105281, Atlanta, GA 30348-5281
- Your credit report should be mailed to you within 15 days

According the Federal Trade Commission: Only one website is authorized to fill orders for the free annual credit report you are entitled to under law — ***annualcreditreport.com***. Other websites that claim to offer "free credit reports," "free credit scores," or "free credit monitoring" are not part of the legally mandated free annual credit report program.

It is a good idea to check your credit report regularly. This allows you to know what is in your file, gives you a chance to correct any inaccuracies, and helps you protect yourself from identity theft.

The report will show your payment history and whether accounts are paid on time.

Your credit report will include:

- your name,
- current and past addresses,
- your employer,
- any judgments or court actions against you,
- a list of credit accounts you have now and past closed accounts,
- whether closed accounts were paid by you or written off by the creditor,
- any debt management program,
- bankruptcies up to ten years.

If there is any incorrect information on your report, you are entitled to ask that the information be corrected. Use the process indicated for the credit bureau you are checking. Remember, only incorrect information can be removed from your file. You may include a statement in your credit files explaining circumstances surrounding any negative entries.

If you are denied credit, or someone takes action against you based on information from a credit report, you must be given the name, address, and phone number of the credit bureau that supplied the report. Within 60 days of getting that notice, you are entitled to request a free credit report to check on the accuracy of the information.

Your credit history not only has an influence on your future ability to obtain credit, it also can impact your ability to obtain a job, housing, or insurance:

- Prospective employers may check your credit history to gain information about your reliability and your trustworthiness.
- A landlord may check your credit history before renting an apartment or house to you.
- An insurance company may run a credit check on you before issuing a policy or before establishing rates you will pay for insurance.

How Do You Establish Credit?

It can take time to build a positive financial history. Here are several ways you can establish good credit:

- Open a checking account or a savings account or both. These do not begin your credit file but may serve as evidence that you have money and know how to manage it.
- Apply for credit at a local store. Ask if they report to a credit bureau. If they do and you pay your bills on time, you are building a good credit history.
- Obtain a secured credit card. You can do this by opening an account at a bank, savings and loan, or a credit union, and depositing an amount of money that will secure your line of credit. Your credit line will be a percentage of the amount you keep on deposit.
- Ask someone with a good credit history to co-sign a loan for you. The co-signer promises to pay your debts if you do not. Beware: your relationship with a co-signer will be damaged if you do not pay as agreed.
- If you have no credit history at all, ask for a credit builder loan at your bank. Credit builder loans are small loans that are paid back over time. Their primary goal is to help you establish a credit history.

Should You Use Credit?

Say you want a new television, but you do not have the money for it. What do you do? Do you borrow the money, or do you wait until you can save some money and buy it later? Consider the 20 percent rule. Your total debt load (except for your mortgage payment) should not exceed 20 percent of your after-tax income. This maximum may still be too high for some families, particularly those with an uncertain job future, a low income, an irregular income, or a large household.

Activity 4-1: Credit Signal Light

Worksheet 4-1: Credit Signal Light

Total monthly
take-home pay = $_____

Total monthly
debt payments = $_____

(excluding home mortgage)

20% of
take-home pay: = $_____

10% of
take-home pay = $_____

RED – STOP!
If your monthly credit payments are 20% or more of your take-home pay, STOP! You are at a red light on the road to financial security and you need to STOP buying more on credit. Focus on paying off your credit debt.

YELLOW – CAUTION!
If your monthly credit payments are between 10% and 19% of your take-home pay, use CAUTION! Control new credit use and pay down your current credit debt.

GREEN – PROCEED CAREFULLY!
If your monthly credit payments are 10% or lower, you are using credit wisely, but proceed carefully. Continue to keep credit debt under 10% of your take-home pay.

Use Activity 4-1, above, to see how well you do managing credit. Write down how much money you bring home monthly. Multiply the amount by 0.20 for the maximum amount of credit you can afford. Compare this to your current monthly payments as listed on the **Worksheet F in Lesson 2 Know What You Owe**.

Now decide. Can you really afford to purchase that new television? Consider carefully before obligating any of your future income.

Recognizing and Dealing with Credit Problems

The best way to handle debts is to avoid them in the first place. But for most families, that is very difficult to do. If you answer "Yes" to two or more of the statements in **Activity 4-2: Recognizing Trouble** (next column) then it is time for you to do something to better manage your debt load.

It is very easy to make purchases when all you do is pull out the card. Many people use credit to make ends meet and then find it difficult to make the monthly repayments. If you have trouble just meeting your monthly payments, let it be a warning to you to cut back on credit use. If you have a hard time avoiding impulse buying, leave the credit cards at home.

Notify your credit card issuer if you see a charge you or your family members did not authorize. If

Activity 4-2: Recognizing Trouble

Can you recognize the credit danger signals? Answer these statements as they apply to you. Check YES or NO.

Yes	No		
☐	☐	1.	Fail to save money.
☐	☐	2.	Always run out of money before payday.
☐	☐	3.	New monthly charges are MORE than account payments.
☐	☐	4.	Longer time needed to pay account balances.
☐	☐	5.	"Juggling" payments to creditors.
☐	☐	6.	Borrow to pay "fixed" costs such as insurance.
☐	☐	7.	Credit card "cash advances" used to pay everyday expenses.
☐	☐	8.	Creditors call and send letters demanding payment of overdue bills.
☐	☐	9.	Unsure how much you owe.
☐	☐	10.	Frequently late in paying bills.

Now, total up the number of "yes" blanks you have checked.

1 "Yes" = Signals Caution
2 "Yes" = Trouble Brewing
3+ "Yes" = You should be very concerned and need to take some steps now to help correct the problem.

you don't have your account online, write credit card amounts on your Day-to-Day Dollar Tracker, or the spending log notebook you started in Lesson 1.

To be helpful, creditors must know of problems before payments are overdue. Working out a plan with a creditor is the best strategy.

If you feel overwhelmed by your debt load, consider working with a credit counseling agency. You can find more information in Lesson 5 about how to contact a credit counseling agency in your area.

The U.S. Department of Justice has resources that address credit counseling & debtor education. Visit their website at ***justice.gov*** and use their search fields to locate up-to-date resources.

- A helpful tool is a free POWERPAY computer analysis to look at different ways to pay off credit. Go to ***powerpay.org***
- Contact a non-profit consumer credit counseling service for help. Find a non-profit agency through the National Foundation for Credit Counseling's website at: ***nfcc.org/locator*** or call at 800-388-2227.

Be honest about how much and when a payment can be made. If a creditor is willing to accept less than full payment at a time that is convenient for you, get it in writing and be sure to follow through on the promise.

- Do not use any more credit until you are in better financial shape. Put your credit cards away in a safe place so you will not be tempted to use them. You may decide to cut them up and close the account. Some debt counselors use this technique with clients before working with creditors to adjust payments.
- If you see you will not be able to make your payments, contact your creditors. If you do not contact them about your financial difficulties, and do not make scheduled payments, your account may be turned over to an independent collection agency. However, many creditors, if they know the facts about your financial problems and of your intent to pay, may agree to defer payments or refinance the debt to reduce the size of your monthly payments. Many are willing to make other arrangements with you.

Be Credit Wise

At a given interest rate, borrowing a smaller amount of money will result in a lower overall credit cost to you. So, a larger down payment lowers the total amount you will have to pay in finance charges.

The longer you take to repay your debt, the more you will pay. The cost will vary with how long you take to pay. Try to take the shortest repayment period possible and make the highest monthly payments you can safely afford.

Credit can be a friend or a foe for the family money management plan. Unwise use of credit can ruin future plans. If you find your debts have piled

Action Steps for Lesson 4:

- Complete Activity 4-1 "Credit Signal Light"
- Complete Activity 4-2 Recognizing Trouble.
- If you don't have credit and would like to start your credit history, apply for a credit card in your name. Use **Worksheet J: Choosing a Credit Card**, at the end of this lesson as a guide.
- If you already have credit, or if you're unsure, send for your credit report from one or all three of the major credit bureaus. Use ***annualcreditreprot.com*** or the hard copy request form at the end of this lesson.
- If you have credit cards or loans, review **Worksheet F: Know What You Owe**, in Lesson 2 and be certain all your debts are listed and identified as secured or unsecured

Plan a strategy for paying off your debt. Consider paying off accounts that charge the highest Annual Percentage Rate a priority.

up and you feel as if you are out of control, develop a plan to help solve the problem. Getting out of debt takes work and self-discipline. It cannot be done overnight, but it can be done!

More Information and Sources

"How Much Debt is Too Much Debt?" by Rosemary K. Heins Revised by Sharon Powell (April 2016), University of Minnesota Extension. The University of Minnesota Extension has a publication titled: "How much is too much debt?" and other resources on personal finances. Visit ***extension.umn.edu*** to find out more.

Consumer Information from the Federal Trade Commission (600 Pennsylvania Ave, Washington D.C. 20580: ***consumer.ftc.gov*** (search by title):

Rent to Own (March 2015)
Debt Collection (May 2015)
Credit Scores (September 2013)

The Credit Score Quiz at:
creditscorequiz.org/quiz.html

Author information

Visit OSU Extension at ***extension.osu.edu*** and eXtension at ***extension.org***

Updated 2019 by Melanie Hart, Candace Heer, Lauren Jones, Caezilia Loibl, and Kathy Michelich based on previous versions by Nancy Hudson and Diane Johnson (2009); Eleanor Ames (1994); and Ella Mae Bard, Nancy Hudson, Diane Johnson, and Carolyn McKinney (1996).

Worksheet J: Choosing a Credit Card

Shop around when you choose a credit card. Card issuers differ in the fees, charges, and benefits they offer. Use **Worksheet K: Credit Card Comparison** below to record the facts as you compare credit cards. Consider the following important features:

- **Annual Percentage Rate** (APR). APR is the cost of credit expressed as the yearly interest rate. It is used to figure the finance charge on the outstanding balance for each billing period. The cost of credit depends on where you borrow, your credit history, how much you borrow, and how long you take to repay it. Credit costs will vary from lender to lender. Before you borrow, compare the APR at several places. The APR can be raised if you fail to pay your bill on time or violate some other provision of your credit agreement/contract. Be sure to read and understand all of the "fine print."
- **Annual Fees**. Card issuers can charge an annual fee to use their credit card. However, most cards have no annual fee.
- **Transaction Fees and Other Charges**. Most card issuers charge a fee for cash advances, fees for being over the balance limit, fees for late payment, or may charge a fee for every month you use the card. Check out these fees before deciding on a card.
- **Grace Period**. The time between the date of purchase and the date interest starts being charged on that purchase is the grace period. If you pay your current balance in full within the stated grace period, no interest is charged for the new purchase. If you carry a balance rather than paying off your card in full, you won't get a grace period on new purchases. Cash advances generally have no grace period.
- **Customer Service and Other Benefits**. Nearly all credit card companies have 24-hour toll-free telephone numbers to assist cardholders with problems. Other special services might include credit card protection, rebates, discounts, insurance, or possibly airline miles.

Worksheet K: Credit Card Comparison

Credit card features	Card 1	Card 2
"Teaser" or introductory rate		
Annual Percentage Rate (APR) for purchases		
Annual Percentage Rate (APR) for balance transfers		
Annual Percentage Rate (APR) for cash advances		
Number of days without interest (statement closing date)		
Annual fee/Annual membership fee		
Finance charge on cash advances		
Penalty fee for late-payment		
Penalty fee for returned payment		
Penalty fee for overlimit		
Amount of minimum payment		
Minimum interest charge		
Transaction fees		

The Annual Credit Report Request Form is availalbe at:
consumer.ftc.gov/articles/pdf-0093-annual-report-request-form.pdf

EQUIFAX experian TransUnion

Annual Credit Report Request Form

You have the right to get a free copy of your credit file disclosure, commonly called a credit report, once every 12 months, from each of the nationwide consumer credit reporting companies - Equifax, Experian and TransUnion.

For instant access to your free credit report, visit www.annualcreditreport.com.

For more information on obtaining your free credit report, visit www.annualcreditreport.com or call 877-322-8228.

Use this form if you prefer to write to request your credit report from any, or all, of the nationwide consumer credit reporting companies. The following information is required to process your request. **Omission of any information may delay your request.**

Once complete, fold (do not staple or tape), place into a #10 envelope, affix required postage and mail to:
Annual Credit Report Request Service P.O. Box 105281 Atlanta, GA 30348-5281.

Please use a Black or Blue Pen and write your responses in PRINTED CAPITAL LETTERS without touching the sides of the boxes like the examples listed below:

A B C D E F G H I J K L M N O P Q R S T U V W X Y Z 0 1 2 3 4 5 6 7 8 9

Social Security Number: ___ - __ - ____

Date of Birth: __ / __ / ____
Month Day Year

Fold Here — Fold Here

First Name **M.I.**

Last Name **JR, SR, III, etc.**

Current Mailing Address:

House Number **Street Name**

Apartment Number / Private Mailbox **For Puerto Rico Only: Print Urbanization Name**

City **State** **ZipCode**

Previous Mailing Address (complete only if at current mailing address for less than two years):

House Number **Street Name**

Fold Here — Fold Here

Apartment Number / Private Mailbox **For Puerto Rico Only: Print Urbanization Name**

City **State** **ZipCode**

Shade Circle Like This → ●

Not Like This → ⊗ ✓

I want a credit report from (shade each that you would like to receive):

- ◯ **Equifax**
- ◯ **Experian**
- ◯ **TransUnion**

◯ **Shade here if, for security reasons, you want your credit report to include no more than the last four digits of your Social Security Number.**

If additional information is needed to process your request, the consumer credit reporting company will contact you by mail.

Your request will be processed within 15 days of receipt and then mailed to you.

31238

Family and Consumer Sciences
342 Campbell • 1787 Neil Avenue • Columbus, OH 43210
fcs.osu.edu • 614-688-5378 • *fcs@osu.edu*

College of Education and Human Ecology
College of Food, Agricultural, and Environmental Sciences

Manage Your Money

Lesson:

1 - 2 - 3 - 4 - 5 - 6

THE OHIO STATE UNIVERSITY