

Money Mechanics

Credit

CREDIT IS HAVING NOW *and paying later. Credit is easy to get today, but the privilege is easy to abuse. This publication will help you understand when and how much to borrow, and give you tips on how to shop for credit.*

Advantages, Disadvantages

Credit itself is neither good nor bad. It depends on how you use it. Using credit has advantages. Credit cards are convenient and much safer to carry than large amounts of cash. Buying on credit also allows you to use goods you can't afford to pay for right on the spot.

For some families, buying "on time" can be a form of forced savings. They find it easier to pay off a loan than to save money for a purchase. However, since credit adds to an item's cost, this may not be the best way to manage money.

Using credit also has some disadvantages. Credit has a cost—you are renting someone else's money. You must pay back what you borrow by a certain date, plus pay interest. You may be tempted to buy more than you really need, just because it's easy to say "charge it." Families who habitually buy on credit can end up adding as much as 18 percent or more to the cost of goods and services. Finally, if you've tied up too much income in credit payments, you may have trouble paying for basic needs.

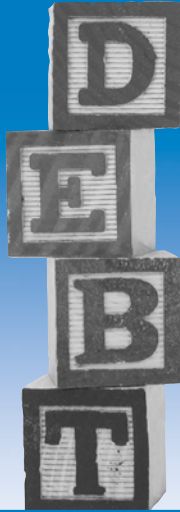
The Credit Decision

You have to decide when to use credit and when to use another alternative to get the things you want. For example, consider your choices for a \$400 television.

- **Rent it with the option to buy.** You would pay about \$13 per week for about 78 weeks, making the total cost a bit more than \$1,000.
- **Buy it on credit.** With an 18 percent interest rate and 18 months to pay it back, your total cost would be \$460.
- **Save for it.** Save \$13 per week and pay cash for the television in 31 weeks. This is the lowest cost alternative—\$400.

Think carefully before you purchase something on credit. Do you need it? Is it worth the extra cost? And most important, can you pay back the money?

Danger Signals



These signals may indicate you're headed for credit problems.

- You find yourself paying only the minimum balance due.
- You can't pay all the bills that come due each month, so you pay some and ignore others.
- You are always out of cash and tend to charge items you used to pay for on the spot.
- You borrow money to pay old debts.

If you can't pay a debt, talk to the creditor. The worst thing you can do is to ignore it. Explain why you can't pay. Suggest an alternative payment plan that you can handle. Most creditors will cooperate, since it provides some hope that the money will be paid back. The creditor's remedies—repossession, hiring a collection agent, or garnishing wages—are unpleasant and costly. If you don't meet these new commitments, many creditors will take immediate legal action.

Many financial advisers suggest avoiding a commitment of more than 20 percent of take-home pay to debt repayment (excluding home mortgage).

How Much Is Too Much?

Many financial advisers suggest avoiding a commitment of more than 20 percent of take-home pay to debt repayment (excluding home mortgage). Some recommend committing no more than 10 to 15 percent to consumer debts, and this amount should be repaid within 24 months.

The worksheet, *Analyzing Your Debts*, PM 1459b, will help you figure your current consumer debts. ISU Extension offers a free computer analysis for paying your debts. Contact your county extension office or see www.powerpay.org to do your own PowerPay analysis online.

Cost of Credit

How much you pay for credit is influenced by how much you borrow, how long you borrow, from whom you borrow, whether you borrow with or without collateral, and what's in your credit record. To keep credit costs down, do some comparison shopping.

Look for these two terms: finance charge and annual percentage rate. The finance charge is the total dollar amount you must pay for credit. The annual percentage rate (APR) is the yearly charge for credit stated as a percentage. The APR is the rate you pay per dollar per year for the credit you use. The lowest APR is usually the best credit buy. However, consider the size of the payments and the total cost of the loan as well.

Table 1 shows the approximate monthly payment required on a \$1,000 loan with different terms and APRs. For example, let's say you want to know the monthly payment for a \$4,000 loan financed for 24 months at 11 percent APR. Refer to table 1 to find the monthly payment for a \$1,000 loan with the same terms (\$46.61). Multiply this amount by 4 since the loan amount is \$4,000. The monthly payment is \$186.44.

Analyzing Your Debts Worksheet

This worksheet will help you analyze your current debt commitments (excluding a home mortgage loan). The average consumer probably will not want to commit more than 10 to 20 percent of income after taxes to installment payments.

Loan	Amount Still Owed	Source of Loan	Annual Percentage Rate	Months Left to Pay	Monthly Payment
Car					
Education debt					
Automatic overdraft on checking account					
Installment loans					
Credit cards					
Other					

If B is greater than C, you have about as much debt as you can carry with your income. Before using more credit, pay off some of your debts, especially those with the highest annual percentage rate of interest.

- A. Monthly take-home income \$ _____
- B. Total monthly payments \$ _____ (total last column)
- C. Monthly take-home divided by 6 \$ _____ (about 17 percent)

Analyzing Your Debts Worksheet

This worksheet will help you analyze your current debt commitments (excluding a home mortgage loan). The average consumer probably will not want to commit more than 10 to 20 percent of income after taxes to installment payments.

Loan	Amount Still Owed	Source of Loan	Annual Percentage Rate	Months Left to Pay	Monthly Payment
Car					
Education debt					
Automatic overdraft on checking account					
Installment loans					
Credit cards					
Other					

If B is greater than C, you have about as much debt as you can carry with your income. Before using more credit, pay off some of your debts, especially those with the highest annual percentage rate of interest.

A. Monthly take-home income \$ _____

B. Total monthly payments \$ _____ (total last column)

C. Monthly take-home divided by 6 \$ _____ (about 17 percent)

For more information, visit
www.extension.iastate.edu/finances or
www.extension.org/personal+finance
 or the Iowa State University Extension
 office in your county.

Prepared by Cynthia Needles Fletcher, professor and extension specialist, Department of Human Development and Family Studies, and Laura Sternweis, extension communication specialist.
Designed by Mary K. Sailer, Spring Valley Studio.

... and justice for all
 The U.S. Department of Agriculture (USDA) prohibits discrimination in all its programs and activities on the basis of race, color, national origin, gender, religion, age, disability, political beliefs, sexual orientation, and marital or family status. (Not all prohibited bases apply to all programs.) Many materials can be made available in alternative formats for ADA clients. To file a complaint of discrimination, write USDA, Office of Civil Rights, Room 326-W, Whitten Building, 14th and Independence Avenue, SW, Washington, DC 20250-9410 or call 202-720-5964.
 Issued in furtherance of Cooperative Extension work, Acts of May 8 and June 30, 1914, in cooperation with the U.S. Department of Agriculture. Jack M. Payne, director, Cooperative Extension Service, Iowa State University of Science and Technology, Ames, Iowa.

Table 1
Monthly Payment on a \$1,000 Consumer Loan

Maturity in Months	Annual Percentage Rate (APR)							
	9	10	11	12	15	18	24	30
12	\$87.45	\$87.92	\$88.38	\$88.85	\$90.26	\$91.68	\$94.56	\$97.49
18	59.60	60.06	60.52	60.98	62.38	63.81	66.70	69.67
24	45.68	46.15	46.61	47.07	48.49	49.92	52.87	55.91
30	37.35	37.81	38.28	38.75	40.18	41.64	44.65	47.78
36	31.80	32.27	32.74	33.21	34.67	36.15	39.23	42.45
48	24.88	25.36	25.85	26.33	27.83	29.37	32.60	36.00
60	20.76	21.25	21.74	22.24	23.79	25.39	28.77	32.35

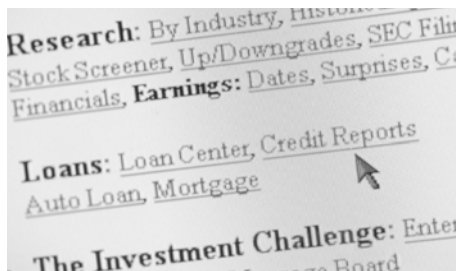
Credit Shopping Tips

- **Use your telephone or the Internet.** Before you “sign on the dotted line,” contact several creditors and compare rates.
- **Consider the time period for repaying the loan.** The more time you take to pay back what you borrow, the more it will cost you. If you borrow \$4,000 at an APR of 12 percent for two years, the total finance charge will be \$519. If you repay over four years, the finance charge becomes \$1,056. Of course, the monthly payments are lower (\$105 compared to \$188), but you must decide if the extra time is worth what it costs.
- **Look at the “cash price.”** The cost of borrowing can be hidden in the price of merchandise.
- **Credit life insurance is usually optional.** In most instances, you don’t have to buy credit insurance unless you want it.

Credit Reports

Your personal history of credit use will affect whether or not you can get a loan and how much it will cost. If you’ve used credit, you probably have a file at a credit bureau. Your payment history plus specific information from public records, such as a tax lien or bankruptcy, are recorded in your file. When you apply for credit, the creditor usually asks the bureau for a report on you. Your credit report may have a summary credit score based on your credit history that indicates if you might be a good credit risk. Like your credit history, your score may vary from one credit bureau to another. Credit bureaus do not make decisions about granting credit. That’s up to the lender.

It’s a good idea to periodically check the accuracy of information in your file at the credit bureau. Federal law allows you to obtain a free credit report each year from each of the major credit reporting agencies. You will be charged a small fee for additional requests of your report. For a copy of your free report, call (877) 322-8228, visit www.annualcreditreport.com, or print and complete the form available at www.ftc.gov/credit and mail it to Annual Credit Report Request Service, P.O. Box 105281, Atlanta, GA 30348-5281. The law does not entitle you to a free copy of your credit score, but you can purchase it at the same time for a small fee.



Federal law allows you to obtain a free credit report each year.



Make a list of your credit cards, including the number to call if they are lost or stolen.

Credit Rights

Consumer credit laws can help you shop for credit, apply for it, keep up your credit standing, and resolve credit-related problems.

- In cases of billing errors, the law sets a correction procedure. First, notify the creditor in writing within 60 days after the bill was mailed. Identify the error and explain why you believe the bill is wrong. Pay the rest of the bill. While waiting for an answer, you do not have to pay the amount in question or any finance charges that apply to it. The creditor must acknowledge your letter within 30 days. Within 90 days after receiving your letter—or within two billing cycles, whichever is less—the creditor must either correct your account or explain why the bill is correct. If no error is found, the creditor may bill you for the finance charges that have accumulated while you were disputing the bill.
- If your credit card is lost or stolen, you are responsible for only \$50 of the charges made by someone else before you report that the card is missing. If no charges were made before the card was reported missing, you will not be liable for any amount. Keep a list of your credit card numbers and report a loss immediately.
- Federal law prohibits debt collection agencies from using abusive, deceptive, and unfair practices to collect debts. Phone calls at unusual hours, repeated calls, threats, or calls to the debtor's employer are not allowed. This law does not apply to lenders who collect their own debts.

For more information, visit
www.extension.iastate.edu/finances or
www.extension.org/personal+finance
or the Iowa State University Extension
office in your county.

Prepared by Cynthia Needles Fletcher, *professor and extension specialist, Department of Human Development and Family Studies*, and Laura Sternweis, *extension communication specialist*.
Designed by Mary K. Sailer, *Spring Valley Studio*.

. . . and justice for all

The U.S. Department of Agriculture (USDA) prohibits discrimination in all its programs and activities on the basis of race, color, national origin, gender, religion, age, disability, political beliefs, sexual orientation, and marital or family status. (Not all prohibited bases apply to all programs.) Many materials can be made available in alternative formats for ADA clients. To file a complaint of discrimination, write USDA, Office of Civil Rights, Room 326-W, Whitten Building, 14th and Independence Avenue, SW, Washington, DC 20250-9410 or call 202-720-5964.

Issued in furtherance of Cooperative Extension work, Acts of May 8 and June 30, 1914, in cooperation with the U.S. Department of Agriculture. Jack M. Payne, director, Cooperative Extension Service, Iowa State University of Science and Technology, Ames, Iowa.