You receive goods or services **today**

With the promise to pay back the determined amount of money (usually in small increments plus interest) in the **future**

Credit availability depends on if lenders trust you will pay back the loan as agreed.
There are many sources of credit including...

- Credit card companies
- Depository institutions
- Automobile dealerships
- Pawn shops
- Government
- Insurance agents
- Private mortgage companies

What credit sources provide the most favorable terms?
WHEN YOU BORROW YOU ARE SPENDING FUTURE INCOME

Interest is typically paid for the convenience of using credit

Toby’s Automobile Loan

$10,000 loan

8% annual interest rate

$1,280.96 paid in interest

Monthly payments for 3 years

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Funded by a grant from Take Charge America, Inc. to the Norton School of Family and Consumer Sciences Take Charge America Institute at the University of Arizona
CREDIT CAN BE...

An effective tool **if** managed responsibly

Create financial stress and negatively impact quality of life and financial well-being **if not** managed responsibly
## MANAGING CREDIT RESPONSIBLY
### EVALUATE THE PURPOSE

**Ask Yourself**

Does the loan/credit provide long-term benefits?
Is the item a want or a need?

| Investing in your human capital with an education loan | Purchasing a vehicle to get to and from work with an automobile loan | Having a credit card to securely make online purchases and for emergencies |

Even if the loan provides long-term benefits, the credit terms should still be favorable.
MANAGING CREDIT RESPONSIBLY
CONSIDER YOUR OPTIONS

Ask Yourself
• Is using money you already have in a saving or investment account a better option?

Ask Yourself
• Can you wait to purchase the item until you have enough money saved?

Benefits:
- No contract
- No interest or fees
- You are not spending future income
A contract outlines **how** and **when** you will pay the money back.

- Are the terms (such as interest rate) favorable?
- Is the loan feasible **both** in the present and in the future?
- Are the terms consistent for the life of the loan?
AMOUNT YOU BORROW

Amount you borrow

- Total amount should be less than 20% of annual net income
- Monthly payment should be less than 10% of monthly net income

Housing payments are **not** included as a part of the monthly 10%

Why should individuals limit their debt?
CLOSED-END CREDIT
(INSTALLMENT)

What it is...
Loan which the borrower must repay the amount in a specified number of equal payments

Features...
Contract outlining repayment terms

Examples...
Mortgage
Automobile loan
Personal loan
Student loan
Toby applied for a $10,000 automobile loan at 8%. He signs a contract with the lender to pay $313.36 per month for 36 months to repay the loan.

Toby could pay more than $313.36 per month to pay off the loan earlier, but he must pay at least $313.36 per month.
**OPEN-END CREDIT**
*(REVOLVING)*

**What it is...**
Extended line of credit established in advance

**Features...**
Loan may be paid (usually monthly) in a single payment or series of unequal payments

**Example...**
Credit card

Did Toby have closed-end or open-end credit?
EXAMPLE
OPEN-END OR REVOLVING CREDIT

Whitney charged $200 to her credit card with a 13% interest rate. She receives her credit card bill with a $20 minimum payment.

Whitney has many options for paying back the $200 as long as she makes the minimum payment.
ALTERNATIVE CREDIT

May combine elements of closed and open-end credit

Usually has higher interest rates

Usually has higher fees
The loan...
- Total loan: $350
- Lender fees: $60
- Amount the borrower receives: $290

On the agreed upon date (usually payday)...
- Lender seeks their fees
- By depositing the check or withdrawing the money

If the borrower does not have money in their account...
- Accumulate fees and possible legal action
- Or, pay $60 fee again to keep the existing loan outstanding or take out a new loan

Types of alternative credit: Payday Loan

Short-term loan that provides immediate cash by securing a borrower’s written check or automatic withdrawal form.
Mario needs $300 to pay his car payment. He uses a payday lender.

**Directions**
- After each roll, record:
  - Number rolled
  - Payday loan activity
  - Cost
- Calculate the total cost of the loan

**Discussion Questions**
- How much did Mario pay total?
- If Mario could not pay back the loan until April, what happened with his other car payments?
TYPES OF ALTERNATIVE CREDIT
RENT-TO-OWN

Borrower leases tangible items with the condition that the item will be owned by the renter if the term of rent is completed.

Purchase a 50” LCD TV valued at $1,890
Pay $39.99 per week for 104 weeks
Total paid: $4,158.96
Interest rate paid: 92%

What are alternative options?
THE LOAN...
Borrower gives the lender their automobile title or personal property in exchange for cash (based on value of item).

TO GET THEIR ITEM BACK, THE BORROWER MUST...
Pay the lender back cash and fees/interest within a specified time period.

IF CREDIT TERMS ARE NOT MET...
The lender keeps the item.

WHAT ARE ALTERNATIVE OPTIONS?
**TYPES OF ALTERNATIVE CREDIT**

**REFUND ANTICIPATION LOAN**

<table>
<thead>
<tr>
<th>Step</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Lender gives borrower a loan based upon their anticipated tax refund.</td>
</tr>
<tr>
<td>2.</td>
<td>Lender charges the borrower a fee for this service.</td>
</tr>
<tr>
<td>3.</td>
<td>Borrower authorizes the Internal Revenue Service to deposit money directly into the lenders account.</td>
</tr>
<tr>
<td>4.</td>
<td>If the borrowers refund was less than the loan amount, they owe the lender the difference.</td>
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</tbody>
</table>
What type of loans typically advertise no credit check?

- Credit application: A form requesting information about a credit applicant.
- Typical questions: Personal information, Credit requested, Information about your ability to repay the credit.
- Credit history check: Evaluate your credit report and score.

The trade-off to no credit history check is often higher interest rates and fees.

Exact process depends on the type of credit and lender.
SHOPPING FOR CREDIT

- Shop around with different lenders!
- Terms of credit are outlined in the contract
- Read the contract carefully!
- Ask questions!
SHOPPING FOR CREDIT
EVALUATE THE CONTRACT CAREFULLY!

What is the annual interest rate?

Are there fees?

What are the consequences of a missed or late payment?

What happens if the loan is not paid back in full?

Do you trust and feel comfortable with the lender?
Circle items that are potential red flags

Underline the terms of credit
- Annual interest rate
- Fees
- Consequences of late/missed payments
- Other things to consider

Is this a contract you would sign?
YOU ARE RESPONSIBLE FOR YOUR PRESENT SELF AND FUTURE SELF!

Understand your responsibilities as a borrower

Consider future implications to paying back the amount borrowed

Shop around for the best terms

What types of credit will you need in the next five years? Where will you go to get it?