Student Name *Teacher* *Period*

CREDIT BASICS

***Your present self impacts your future self.* When borrowing, you are spending future income.**

You have used **credit** if you receive money, goods or services in exchange for your promise to pay back a definite sum of money at a future date. Credit involves borrowing. Credit availability depends in large part on whether lenders trust that you will pay back the loan as agreed. Lenders consider you more creditworthy as they gain confidence that you will pay back loans. Sources of credit include but are not limited to depository institutions, private mortgage companies, finance companies, automobile dealerships, credit card companies, retail stores, insurance agents, payday loan companies and pawn shops.

Using Credit Responsibly

You are responsible for yourself.

When you borrow, you are spending future income. You pay back a loan by making regular payments (usually monthly) over time. The lender also typically expects you to pay back interest in addition to the amount borrowed.

For example: Toby was approved for a $10,000 loan at an 8% interest rate to purchase a used automobile. The loan terms require him to make monthly payments of $313.36 for the next three years (36 months) to pay back the loan. In addition to paying back the original $10,000 borrowed, Toby will also be paying a total of $1,280.96 in interest. So, the total amount repaid over the 36 months will be $11,280.96.

Credit is an effective financial tool when managed responsibly. But, not managing your credit wisely and over-obligating your future income can lead to a decrease in your future quality of life and negative financial well-being.

The amount owed for credit is a liability on the Financial Position and decreases total Net Worth (assets – liabilities)

Total Assets	
Liabilities	
Home mortgage balance	
Installment loan balance for automobile	
Student loan balance	
Credit card balance	
Money owed to others	
Other:	
Total Liabilities	$
Net Worth = Total Assets - Total Liabilities	$

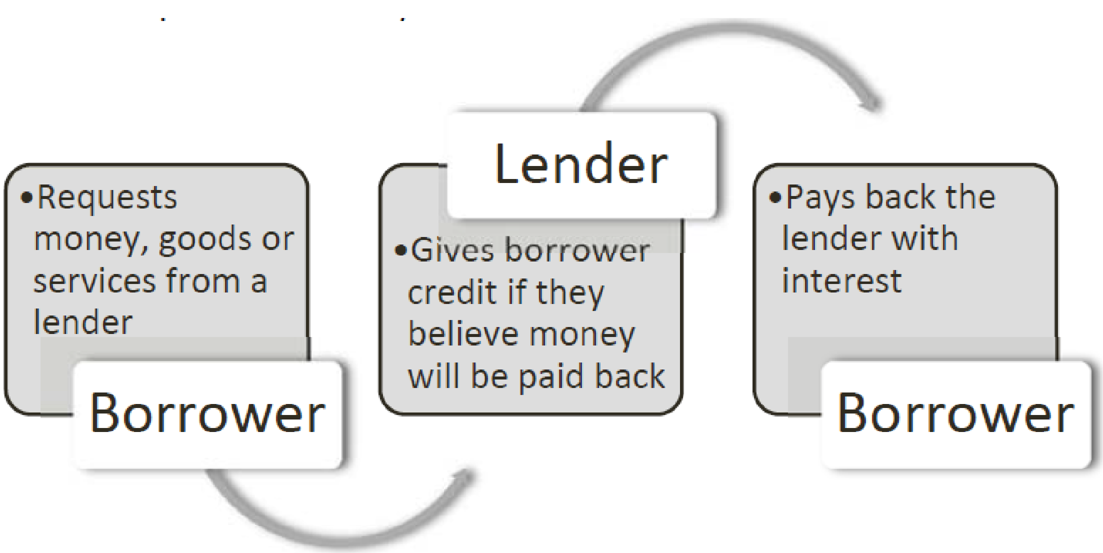
Before you borrow, carefully evaluate the reason(s) for using credit. Are you going to apply for credit to pay for higher education, purchase a home or buy a new car? Borrowing to pay for higher education is a way you can invest in your human capital. This investment may pay off in the future with a better job and higher wages. Similarly, borrowing for a new home or a new car can make sense by securing more comfortable housing or more reliable transportation. But you should think through any purchase that requires you to borrow.

Do you have the option of using your savings or maybe dipping into an investment account as an alternative to borrowing? You may discover one or both of these options are better suited for you. Examine possible penalties for withdrawing funds from your investment account. Those potential penalties may sway your decision.

Remember that a loan is a legal contract. Once you enter into this contract you are required to make payments in the future according to the agreement. Take a look at the impact that your loan payments will have on your budget. Can you manage this monthly payment along with your other financial responsibilities? Financial experts recommend that the total amount borrowed (excluding any mortgage loans) should be less than 20% of your annual net income. Your monthly loan payments (including payments for auto loans, education loans, credit card payments, but excluding any mortgage payments) should not be more than 10% of your monthly net income. Keeping the total amount of credit owed within these limits is a part of using credit responsibly.

Why should individuals limit their total amount of debt?

Credit is when goods, services, or money is received in exchange for a promise to pay a definite sum of money at a future date. The person who is lending the money is saying, in effect, he believes the borrower is willing and able to keep his promise to pay the money back, plus interest. **Interest** is the price of money.



Types Of Credit

There are two types of credit:

- **Closed-end credit** (also known as installment credit) is a loan which you must repay in a specified number of equal monthly payments. Examples of closed-end credit include automobile loans, mortgages, and education loans.
- **Open-end credit** (also known as revolving credit) is extended as a line of credit established in advance, so you do not have to apply for credit each time credit is desired. Credit cards are the most common type of open-end credit. A unique feature of open-end credit is that you can pay the loan balance in a single payment or a series of equal or unequal monthly payments. Your lender will typically require a specified minimum monthly payment towards your outstanding balance.

How will you use credit responsibly?

The following table outlines examples of different types of credit and the most common sources for each type:

Type of Credit	Example	Other Information	Most Common Sources of Credit
Closed-end credit	Mortgage loans	Includes home equity loans	Depository institutions Private mortgage companies
	Automobile loans		Depository institutions Automobile dealerships
	Personal loans		Depository institutions
	Education (student) loans		Government and depository institutions
Open-end credit	Credit cards	There are many different types: ▪ Secured ▪ Retail store	Depository institutions Credit card companies Retail stores

A **credit card** holds pre-approved credit, which can be used for the purchase of items now and payment of them later. In the case of credit cards, individuals can borrow as much money as needed as long as they do not go over the **credit limit,** which is the maximum amount of money that can be charged on the credit card. Every credit card has a different credit limit amount, which may be large or small. The amount of money charged on a credit card may be paid back in one single payment or a series of equal or unequal monthly payments. However, *interest* is charged to a credit card each month the amount of money owed is not paid in full. ***The longer the cardholder takes to pay off the amount of money charged, the larger the total interest charges will be***.

Buy now- pay later, what's the catch?

Credit card companies require cardholders to make a **minimum payment**, which is the minimum amount of a credit card bill that must be paid monthly. However, the minimum payment is usually only a small portion of the total amount that the cardholder owes on the credit card. Therefore, ***a cardholder who only makes the minimum payment every month will pay lots of interest and make slow progress toward paying off what is owed*** on the credit card.

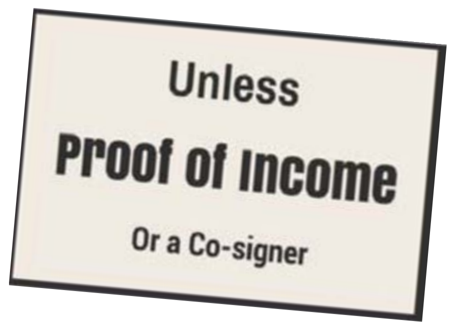
Melissa and Skylar each purchased a plane ticket for $500 using their credit cards that charge 15% APR

Melissa		*Skylar*	
Paid full amount owed $500	Took 1 month to pay off	Paid minimum due $50	Took 3 years to pay off
Paid $0 in interest	Total Paid $500	Paid $104 in interest	Total Paid $604

What would you do with an extra $104?

It is important to understand the difference between a credit card and a debit card. A **debit card** is a plastic card that looks like a credit card but is electronically connected to a checking account at a depository institution account that holds the cardholder's money. When a debit card is used with the PIN to make a purchase, the money is immediately taken out of the account. In contrast, a credit card transition is not linked to an account and money is not withdrawn immediately.

To receive a credit card, consumers must be 21 years of age or older. Consumers under 21 can still get a credit card, but they need to either have a **co-signer** or show documentation of sufficient income to make payments. If someone agrees to be a co-signer on an account, they are equally responsible for the loan.



To obtain credit if you are under the age of 18, you must have an adult co-signer. If you are between the ages of 18 -21, to obtain a credit card you must have a co-signer or proof of sufficient income to make payments.

Make sure co-signers understand that they are equally responsible for the credit, and that it will appear on their credit report as well.

You are responsible for your present self and future self.

You are responsible for understanding your responsibilities as a borrower, including the terms of a credit contract.

Before signing a credit contract, shop around for the best credit terms for you and consider the future implications of paying back the amount borrowed.

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