



Understanding Credit

Guide 3

Because making
the most of your
credit will benefit
your future

Desert Schools Money Matters Series

Guiding you toward financial success



Like your reputation, having good credit takes time and effort to build. But, it can be damaged in a short amount of time. Borrow too much and you may struggle to pay it back. Always remember that credit is a tool to help you get the things you want, like your own home. Your actions, whether positive or negative, will affect your credit score, so learning how to build and manage good credit is very important. After all, we each need credit to improve our lives, not set us back.



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Also available as part of the Desert Schools Money Matters Series:

Making Sense of Money

Managing Your Checking Account

Protecting Yourself from Identity Theft

Understanding Insurance and Investments

Commonly Used Words

APR or Annual Percentage Rate

Amount of interest (in terms of a percent, such as 8.75%) being charged for a loan or line of credit over a year's time

Annual fee

A yearly charge, often used by credit card companies, for borrowing money

Origination fee

A one-time charge for setting up the loan, often associated with home loans

Grace period

At Desert Schools, it's the number of days after your due date in which you can still make a payment and not be charged a late fee

Minimum payment

Usually the monthly payment set forth by the lender; often 2% of your credit card balance

FICO score

The number (from the 300s to the 800s) lenders use to decide whether or not to lend you money

Finance charge

The actual dollar cost of using credit, which the lender calculates

Credit limit

The maximum amount you can charge to a credit card

What is Credit?

Simply put, credit is borrowed money. It's when someone loans you money in exchange for your promise to pay it back, usually with interest, which is the amount you owe to use borrowed money. The higher the interest, the more it will cost you. The person or company lending you money is known as a creditor. Credit can also refer to your history and how you've managed your finances.

5 Main Types of Credit

1. **Secured credit (auto, home loans)** – Your vehicle or home is used as collateral to guarantee the loan; if you do not pay the loan, the creditor has the legal right to take the collateral back.
2. **Unsecured credit (credit cards)** – Creditors take an increased risk to provide you the money, since there is no collateral involved.
3. **Revolving credit (credit cards)** – Creditors approve you for a certain amount you can use at your discretion (e.g. \$500). As you use the money, your available balance decreases, but as you pay the money back, your available balance will increase back to the predetermined amount.
4. **Installment credit (personal, auto, home loans)** – Creditors approve you for a certain amount, create a schedule for repayment and set a fixed payment amount. You also have an amortization schedule that reflects the pay off or installment frequency of the loan.
5. **Share secure loan (savings)** – Unique to Desert Schools, you can build credit with as little as \$100 in a savings account, which acts as collateral. No credit is necessary to qualify; good account management (e.g. pay on time) is what builds a positive credit score.

Understanding the Benefits of Credit

Credit is an essential tool in our economy. When you are able to borrow, you buy things that otherwise would take years to save and afford, like a home or college education. The need to borrow creates a marketplace for these items in our economy.

On a personal level, borrowing is an individual decision. Consider it a financial tool. And, when borrowing, remember that using credit responsibly has its many benefits, including:

- **Access to cash in an emergency** – Be prepared to cover accident costs
- **Ability to use it now** – Benefit from having credit immediately
- **Safety and convenience** – Better than carrying large amounts of cash
- **A higher credit score** – Good credit management positively impacts your FICO score
- **Better interest rates** – Enjoy substantial savings from lower loan rates
- **Financing options** – Good credit helps you get low-interest loans for your home, car, business and other financial needs

Depending on how you use credit, you either establish a good or bad credit history, which shows prospective lenders and employers a record of your borrowing and repaying activities, including information about late payments and bankruptcies.

Bad credit can happen to anyone. Maybe you were late with a payment. Just don't make a habit of it. Lenders will take notice and may report your behavior to Credit Reporting Agencies. This affects your ability to borrow money, and, if you do get approved, you will be faced with higher interest fees.

Example of a \$5,000 installment loan with a time period of 5 years. Compare how much this one loan could cost you, depending on different interest rates.

Interest Rate	Number of Monthly Payments	Monthly Payment	Total Interest	Total Cost
5%	60	\$94.36	\$661.60	\$5,661.60
7%	60	\$99.01	\$940.06	\$5,940.60
9%	60	\$103.79	\$1,227.40	\$6,227.40
11%	60	\$108.71	\$1,522.60	\$6,522.60

Take Charge of Your Finances

Do you have trouble making credit card payments, have little or no savings, keep getting utility disconnect notices and calls from collection agencies? If so, you may consider credit counseling resources. Take Charge America can help you take control of your finances, pay down existing debt, establish a savings plan and become more financially independent. Please visit takechargeamerica.org or call 1-877-822-2410 for financial education, credit counseling and debt management.

Consider Credit Protection for Peace of Mind

No one wants to anticipate illness, disability, sudden death or involuntary job loss. Yet, everyone wants to ensure that his or her home and family are safe, no matter what. Credit life and credit disability protection can safeguard your investments and your family. Call (602) 433-7000 today, and speak with a Desert Schools representative about your credit protection needs.

Establishing Your Credit

When it comes to credit, the most important number to know and understand is your credit or FICO score. It's the number lenders use to decide whether or not they will lend you money. The higher your score, the more likely you will qualify for low-interest credit cards and loans.

How do you start to establish credit? Open a savings and checking account. This will show lenders you have money set aside for future use. Also remember to pay your bills on time, since lenders look at your history of money management, too.

5 Ways to Establish Credit

- 1. Apply for a line of credit on your checking account** – This protects you from overdrafts and is a great introduction to managing borrowed money.
- 2. Apply for a small personal loan** – This isn't secured by property but can be used to afford things, like a computer or car repairs.
- 3. Apply for a department store credit card** – This may be easier to get, but be careful. The interest rates are higher. Use this type wisely, and pay off the balance each month.
- 4. Apply for a credit card at a financial institution** – Many credit unions and banks offer secured credit cards with lower rates; plus, you may be able to use this as a line of credit to protect you from account overdrafts.
- 5. Find a responsible co-signer** – If you can't qualify on your own, you may qualify for a loan with a co-signer (somebody who agrees to assume the debt obligation, if you fail to repay the loan). Be sure to talk with your co-signer about this financial responsibility, for he or she will ultimately be responsible for the loan and its repayment.

Desert Schools Tip #99:

Before applying for a credit card, compare rates. The higher the rate, the more you will pay on what you charge.

Understanding the Lender's Point of View

It's difficult to pinpoint how lenders make their decisions. Each lender has their own guidelines and level of risk they are willing to take. Yet, there are five fundamental elements they consider when evaluating your personal credit.

- 1. Capacity** – If you have stable employment and the ability to repay
- 2. Capital** – Your current financial situation, including assets and other resources to help you pay back the borrowed money
- 3. Character** – Whether or not you've shown you are responsible in managing accounts, paying bills on time and not having accounts go into collections
- 4. Collateral** – If you have an asset that will guarantee your ability to pay back the borrowed money
- 5. Conditions** – Evaluation of the current economic conditions and the risk to lend money out

True or False

Lenders don't look at your past credit history when deciding to loan you money.

(False)

Learn more online

Visit desertschools.org/credit to read more about building, using and managing credit.

Managing Credit Wisely

When you borrow money, the amount you borrow is known as debt. Too much debt can derail your financial plan and affect your future. It's never too soon or too late to learn how to manage this aspect of your financial life more wisely.

Here are a few tips to help you build and manage your credit:

- Only charge what you can afford, and pay it back each month.
- Remember you have to pay interest on every item you charge, so ask yourself if charging that item is worth it.
- Pay more than the minimum payment each month.
- Stop applying for credit card offers after you've been approved for one or two, since every time you submit an application it appears on your credit report.
- Protect your credit score; taking on too much debt will have a negative effect.
- Don't max out your credit cards; try to use only 30% of your available balance.

10 Questions to Ask Before You Use Credit

1. Do I really need this item right now, or can I wait to pay for it when I have the cash?
2. What is the interest rate on this credit card or loan?
3. Are there additional fees I should know about?
4. How much is the monthly payment and when is it due?
5. Can I afford to pay the monthly minimum payment?
6. Do I really need another credit card?
7. Does wanting this item now fit into my future financial plan?
8. Why do I feel like I need to charge this item?
9. What will I have to give up to pay back this debt?
10. Do I have the steady income to help pay off my debt?

Credit Requires Responsibility

Always read the fine print. When you sign a loan or credit card application, you are legally obligated to adhere to what's in the agreement. Don't take this financial responsibility lightly. Because if you fail to repay the money you borrow, lenders can take legal action against you. As a customer, you have rights. Lenders must disclose in writing the total cost of using their credit, as well as be truthful in advertisements. But, this does not mean you should enter into any agreement without fully understanding the terms.

One Day of Shopping Could Take You 13 Years to Pay Off

Imagine you're at your favorite store, picking out clothes. Sounds fun, doesn't it? You pay with your credit card. Your total comes to \$1,100. As planned, you hand over your Visa®, thinking nothing of it.

Now, imagine the bill arrives and you make only the minimum payment due, like most people. If the interest rate on your card is 18%, then the \$1,000 balance will take you 153 payments—or close to 13 years—to pay off. By then, the clothes you bought will be out of style, and you will have paid more than \$2,000 extra for a purchase you made over a decade ago!

4 Steps to Reducing Debt

1

Organize your bills by APR: know which loans and credit cards are costing you more

2

Stop charging: your financial future may depend on it

3

Make a payment plan: pay the most you can on the highest APR loan, while paying the minimum on all others

4

Talk to somebody: if your debt is unmanageable and you feel overwhelmed, talk to a credit counseling agency, like Take Charge America

Reducing Debt

Is debt preventing you from reaching your goals? Then make the commitment today to reduce your debt. Simply determine how much you currently owe. Use the debt worksheet on this page to list any outstanding debt, including student loans and credit cards. Arrange your accounts in order, from the highest to the lowest Annual Percentage Rate (APR) charged. Include mortgage or rent payments.

Creditor	Account Type	APR	Current Balance	Minimum Payment	Due Date
1					
2					
3					
4					
5					
6					
7					
8					
Total			<input type="text"/>	<input type="text"/>	

If you can, use extra income each month to accelerate your debt repayment. Start with the account with the highest APR. Then, when that is paid off, increase your payment to the next account. Remember to make at least the minimum payment on all your accounts.

● What's your debt-to-income ratio?

Look at what you currently owe, like mortgage, credit cards and student loans, and divide that by what you earn (e.g. monthly salary, commission, alimony).

$$\text{Total monthly debt payments} / \text{Total monthly net income} = \text{Debt-to-income ratio (\%)}$$

Place your information in the boxes below.

<i>I owe</i>	/	<i>I earn</i>	=	%
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Understanding Your Results

Less than 30%: Excellent!

30% to 36%: An acceptable range, but work to bring it down below 30%.

36% to 40%: Reduce your current debt load; additional debt may set you back.

40% or higher: Your debt load is heavy, so take action today.

Online Credit Card Calculators

Do you know how much time and money it will really cost you to pay off your credit cards?

Now you can try out different scenarios for interest rates, payment schedules and card types with online credit card calculators at desertschools.org. Simply click the Calculators link in the header of our Web site.

Credit Report Questions

Here are a few commonly asked questions to help you understand what a credit report is and the information it contains.

What is a credit report? A factual record of how you have repaid credit obligations in the past.

How is a credit report used? To predict the risk of lending you money based on your credit history. Banks and credit unions, retail stores, and finance and insurance companies check your credit score. Potential landlords and employers can use your credit report to evaluate your level of responsibility.

What information does a credit report include? Your name, past and present addresses, telephone number(s), Social Security number, date of birth, employer(s), along with detailed information regarding open date, loan amount, credit type, your payment history, including missed or late payments, and any involvement by collection agencies. It also includes any public record of lawsuits, bankruptcies, foreclosures and tax liens, and names of any person or companies that have requested a copy of your credit report.

What information is not in your credit report? Race, religion, medical history, political affiliation, checking or savings account information, or anything else unrelated to credit.

Who else can see your credit report? You can, of course. You have the right to view and correct any mistakes on your credit report. Plus, you're entitled every year to get a free copy of your credit report. Visit annualcreditreport.com for yours. If you apply for a loan or credit card, that lender will request a copy of your credit report. But, rest assured. Credit bureaus do not allow just anyone to see your credit report. In most cases, your permission or signature on the application is required.

What is a CRA? CRA stands for Credit Reporting Agency. There are three primary ones in the United States – Experian, Equifax and TransUnion.

What do CRAs do? They compile credit reports and keep the credit histories of close to 200 million people. If you review your credit report and discover any errors, you would report these to the CRA from which you obtained the report. They are responsible for correcting any inaccurate or incomplete information.

Example of a Credit Report

Credit Items

For your protection, the last few digits of your account numbers do not display.

ABCD BANKS

Address: 100 CENTER RD BUFFALO, NY 10000 (555) 555-5555	Account Number: 1000000...
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Status: **Paid/Past due 60 days**

Date Opened: 10/2005	Type: Installment	Credit Limit/Original Amt: \$523
Reported Since: 11/2005	Terms: 12 Months	High Balance: NA
Date of Status: 04/2007	Monthly Payment: \$0	Recent Balance: \$0 as of 04/2007
Last Reported: 04/2007	Responsibility: Individual	Recent Payment: \$0

Account History:
60 days as of 12-2006
30 days as of 11-2006

What if you find a mistake on your credit report?

You can dispute it. Under the Fair Credit Reporting Act, you are protected from having inaccurate information on your credit report. Write to the CRA and explain the problem. The CRA must investigate and report back to you. If the information can be proven a mistake, it will be removed from your report. If the CRA insists it can't remove the information because it is accurate, you can attach a written explanation about the problem to your file. Limit it to 100 words. Anyone who checks your report in the future will be able to see your statement.

Your application for credit was turned down. What can you do?

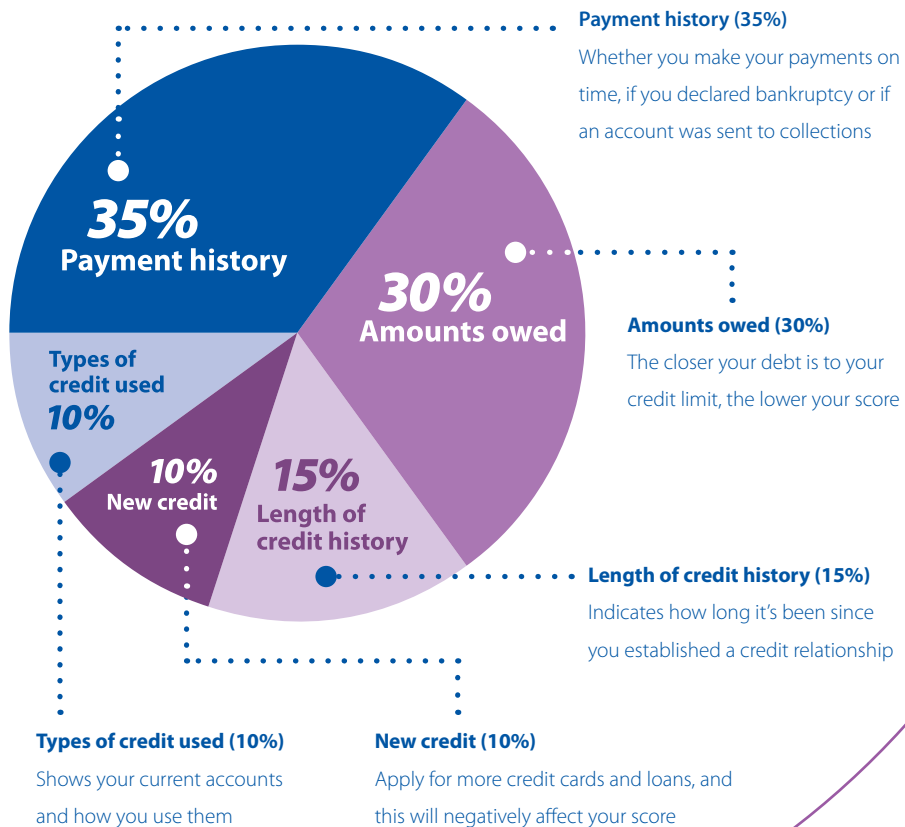
Request a free copy of your complete credit report. Most likely, the lender will state in a letter to you which CRA they used and will provide the necessary contact information for you to contact that CRA directly for more information.

Understanding Your Credit Score

A credit score is a number lenders use to help them decide how likely you will be able to repay borrowed money. Consider it a snapshot of your credit risk. Like blood pressure, a credit score can be healthy or unhealthy. The higher the credit score, the lower the risk is to lend you money.

How are credit scores decided?

Scores typically range from the 300s to the 800s and are established using a computer software created by Fair Isaac Corporation (which explains why a credit score is also called a FICO score). FICO scores are made up of certain areas of information: payment history, amount owed, length of credit history, amount of new credit and types of credit in use.



What do credit scores mean?

In school, you were graded on papers and tests. Consider your credit score to be a grade given to you based on the five areas: payment history, amounts owed, length of credit history, new credit, and types of credit used. The higher the credit score, the better. Scores below 620 will pay more for credit and may have a difficult time borrowing money.

True or False

The longer you pay your bills on time, the better your credit score will be.

(True)

Did you know?

Closing an account doesn't make it go away. It will still appear on your credit report as part of your credit history, so manage all current and future accounts responsibly.

Desert Schools Tip #1:

To review your credit report more often, request a free copy of your credit report from each of the three major CRAs once every other month, and monitor your credit history a total of six times each year, instead of once.

Improving Your Credit

According to FICO (Fair Isaac Corporation), a credit score of 700 – out of a possible 850 – is considered good. People with scores in the 700s tend to get the lowest rates, while those with scores of 650 and below are considered to be at high risk. But, there are things you can do today to start to improve your credit.

There is no quick fix, so be patient. Improving your credit requires time, diligence and responsible credit management. In the long run, taking the steps to improve your credit will help you and your family have a brighter future.

Here are some tried-and-true tips for getting out of debt and improving your credit:

Create a spending plan, and stick to it. For help with that, refer to our *Making Sense of Money* guide in this Desert Schools Money Matters Series.

Use online Bill Pay to schedule payments through your checking account.

If your debt is unmanageable, talk to a credit counseling organization, like Take Charge America (takechargeamerica.org).

Stop applying for more credit cards, and choose to opt-out of pre-screened offers.

Combine repayment with a savings plan. After one card or loan is paid off, redirect half of the money toward building your savings and the other half toward paying off additional debt.

Schedule and send your payments when you receive your statements, or keep a consistent routine for paying bills (e.g. the 1st or 15th of the month).

Understand all the terms and conditions before you sign. Don't be afraid to ask questions.

Commit to paying off your outstanding debt. For help, use the Reducing Debt Plan on page 12.

Limit your credit card use. Don't go into debt for things you really don't need.

Before filing bankruptcy or walking away from your home or bills, talk to Desert Schools about your options.

Praise yourself. When you pay your bills on time and pay off loans, congratulate yourself. The accomplishment deserves recognition.

Keep track of due dates. Remind yourself by using alerts via your phone's calendar or Online Banking.



Personal credit is like your financial identity.

With time, patience and diligence, you can build good credit. Use it wisely, and you will have the opportunity to build more wealth for you and your family.

Understanding Credit helps you do just that – understand credit and its many benefits. In this guide, you'll learn about the different credit types, ways to establish credit, the lender's point of view, credit reports and FICO scores, and ways to reduce debt.

Because making the most of your credit will benefit your future, ***Understanding Credit*** is your guide to developing responsible credit management skills and consistent monitoring practices that will help improve your life.

If you find this guide helpful, please share it with family and friends.

To learn more, call
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by a nearby branch.

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