What is Consumer Credit?

A word about interest: Interest is the amount the creditor charges to allow you to use borrowed money. Interest rates can be "fixed" or "variable". A fixed interest rate stays the same throughout the life of the loan. A variable rate can change from time to time. For example, an adjustable rate mortgage or ARM might start off with an interest rate of 5% but be subject to change if interest rates go up in the future. See how this can impact the monthly housing payment for Ashley and Justin. They recently bought a house that they financed with a $100,000 adjustable rate mortgage (ARM). The interest rate now is 5% and their current monthly payment is $537. If interest rates go up in 3 years when the rate is subject to adjust, their new interest could be as high as 10% and their monthly housing payment will jump to $852.

Credit is being able to use a financial institution's money instead of your own, for a period of time. Perhaps the most familiar type of **credit** is a **credit card**. As a form of "open end" or "revolving **credit**", a **credit card** allows one to purchase goods or services using money borrowed from the **credit card** issuer. As you pay down the outstanding balance on your **credit card** account each month, that amount of **credit** becomes available again for future purchases. Most **credit card** issuers offer a "grace period", meaning that if you pay your **credit card** balance in full each month on or before the "due date", you will not incur any interest charges on the **credit** you've received. However, if you pay less than the full balance each month, interest rates on credit cards can add up fast. Those shoes you bought on sale for a great price using your **credit card** can end up costing you much more than the regular price of the shoes. Interest on the unpaid balance on your **credit card** can quickly wipe out all your savings.

Other forms of credit: Mortgages, student loans and automobile loans are also forms of **credit**. These "closed end" **installment loans** usually have lower interest rates than **credit cards**. These loans are "secured" by your home or your car, so they are less risky for the lender than an open-end unsecured **credit card**. But if you default on a mortgage or a car loan, you could lose your home or your car. Cash advances or payday loans are another common type of **credit.** For a fee, often as high as $35, an individual can get quick cash – even if he has a bad **credit** history. Two weeks later when the individual gets his paycheck, he must pay back the loan plus the $35 loan fee. That can sound tempting, but that $35 fee to borrow money for just 2 weeks can amount to an **APR** of 400% or more. If the amount of his paycheck is insufficient to cover the cost of his bills and pay back the loan plus the $35 fee, he will need an additional loan. Far from being a way to get rich quick, a payday loan can be a way to sink quickly into insurmountable debt.

Reading a Credit Card Statement

Once you start using **credit cards**, your purchases and **finance charges** are counted against your set **credit line** until they are paid. Each month, you will receive a statement for your **credit card** account that tells you how much you have in charges, how much you have paid, what **finance charges** you owe, and what your new balance is. Although statement formats differ, they always contain the following:

1. Your **credit card** number: do not share it or someone else can use your account.
2. The closing date: the date the **credit card** company created the statement.
3. The amount of your credit line/spending limit.
4. **Available credit:** the amount available to you that you haven't used yet.
5. Transactions section: a list of each charge and payment by date.
6. Account summary: summarizes your transactions.
7. Payment information: total amount you now owe or your new balance.

8. Minimum payment: you must pay this at the least. If you wish you can pay more, up to the total. It is a good idea to pay more than the minimum. In fact, it is best to pay as much as you can to avoid interest!
9. Due date: after this date, the credit card company will begin charging interest on the amount you owe. Many companies also charge a late fee or increase your interest rate if you are late.
10. Rate information: shows how the interest and fees are calculated.
11. Payment coupon: repeats your current payment information.

EXERCISE: Search online. Find and read through 2-3 different credit card statements from financial institutions such as: American Express, Bank of America, BB&T, Capital One, Chase, Citi, Discover, Wells Fargo, or any other financial institution you want to check out.

- What are the interest rates?

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- What fees are charged?

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- What items are included in all of the credit card statements?

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- Which items were not included in each statement? Why?

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- What was the penalty for paying late in the credit card statements you chose? Why were the amounts different for each one?

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- What information is included in the account summary? Is this the same for all of the credit card statements? Why/Why not?

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- What information is included in the minimum payment box? Why do they provide you with this comparison?

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Based on the information you found, which institution best fits your needs? Why?

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For more information on how to read credit card statements, see the http://www.federalreserve.gov/creditcard/flash/readingyourbill.pdf

For more information on how credit cards work and to see how much you know about how to manage a credit card wisely, check out HandsOnBanking: http://handsonbanking.org/htdocs/en/y/#/en/y/cr/cca/index.html

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Paying Off Credit Cards

When paying off **credit cards**, the lender will always ask the borrower to pay a minimum amount each month until the debt is paid in full. This amount is usually rather small and easily affordable for most consumers. The catch is by only paying the minimum amount each month, the consumer will have to pay on the account for a longer period of time before paying the debt in full.

Assume the interest rate is 18% annually (1.5% monthly) and the balance is $1,000. We will also assume no new debt will be added throughout the year. Calculate the balance using the following minimum payments: $30, $150, and $300. By looking at three different payment plans, we can determine the best option when it comes to paying off our debt.

Month	Balance	Interest	Payment	Balance	Interest	Payment	Balance	Interest	Payment
1	$1000	$15	$30	$1000	$15	$150	$1000	$15	$300
2	$985		$30			$150			$300
3			$30			$150			$300
4			$30			$150			
5			$30			$150			
6			$30			$150			
7			$30			$150			
8			$30						
9			$30						
10			$30						
11			$30						
12			$30						
End of Year Balance									

1. What is the balance at the end of the year for each payment plan?

A) $30 ____________ B) $150__________ C) $300 _________

2. How much interest did the consumer pay under each payment plan for the year?

A) $30 ____________ B) $150__________ C) $300 _________

3. As a consumer, which payment plan would you choose to pay off your debt? Explain why you chose that op

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4. After reviewing the worksheet, search online for a credit card payment calculator or download a free card payment calculator App. Calculate how much you are really paying when you only pay the mi amount due each month. Some cards calculate your minimum payments as low at 4% of your balan activity will show you how much interest you end up paying in each one of these scenarios.

EXERCISE: Fill out the following chart and answer the questions below.

Balance	Interest Rate	Minimum Payment (1% of balance)	Minimum Payment (2% of balance)	Minimum Payment (3% of balance)	Length of time to pay off debt and the total amount of interest paid for each scenario		
1000	5%	$15	$20	$30			
1000	10%	$15	$20	$30			
All minimum payments are calculated at 1%, 2%, 3% of the balance or at least $15							

After filling out the chart, answer the following question: What conclusions can be drawn about the time it takes to pay off **credit card** debt when we are only paying the minimum amounts?

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Credit Reports

Once you have decided to apply for and use **credit cards,** you need to know how banks and other financial institutions determine whether or not to extend you a new line of **credit**. They will use your **credit score**, sometimes called your **FICO score** (a score developed by Fair Isaac Company – FICO), to determine if you are credit-worthy. A **credit score** is a statistical calculation based on the **credit** histories of thousands or even millions of other borrowers. Your score is based on how other borrowers with characteristics similar to yours have performed on their loans and **credit cards**. In other words, it's a statistical determination the level of risk you, as a potential borrower, pose to a lender. The lower your **credit score**, the more risky you are as a borrower. The higher your score, the less risky you are – because others with histories similar to yours tended to repay their loans on time.

Your willingness to repay **credit** is based on your history of repayment on other financial obligations. Were you able to pay your bills on time or did you have to wait until you received a call or a letter because you were late paying your debts? If you do not have a record of prompt payments, then you might be denied **credit**. Your repayment history is one of the primary factors the will influence your **credit score**.

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