

CREDIT – Part 2

Business Issues



Credit Cards

- Paid over a variable amount of time
- Finance charge (interest) is called annual percentage rate (APR) expressed as a percent: 10-22%
- Some cards charge annual fees (\$25, \$50)
- Some cards will have a **grace period** – amount of time to pay all charges to avoid paying the APR: example: 25 days
- Most cards will require a **minimum payment** – the amount due; 2, 3, or 5% of balance

- Most cards have a **credit limit** – maximum amount one can charge on a credit card
- Receive a credit card statement (usually monthly)
- Transaction fees and other charges: late fees, cash advance fees, transfer balance fees; over limit fees
- Major credit cards: Visa, MasterCard, Discover, American Express
- Store credit cards: Target, Kohls, Nebraska Furniture Mart

Installment loans

- 1-5 year loans for purchases such as car, furniture, boat, appliances
- Banks, “cash stores”, auto dealers offer these types of loans
- Agreement with a set payment amount for a specified period of time

Student loans

- Used for college tuition, room, board, books, etc.
- Usually don't start paying until 6 months after you graduate or are finished with school
- Paid over 10 years (the max amount)
- Interest rates: 2-8%
- Banks & federal government issue these types of loans
- Interest is tax deductible

Mortgage

- Loan for a house, farm land, business
- Usually spread over many years (10-30)
- Interest rates vary depending on economy, bank, borrower and length

Applying for credit

- Complete & submit a credit application
- Information on an application:
 - Name, address, SSN, birthday, employment and income information, credit and banking history, personal references, permission to review the applicant's current credit file
- Answer all questions completely and honestly

Approval Process – 3 C's of Credit

- Lenders need to be able to **TRUST** that the borrower will keep their promise to pay a debt
- **Credit**: applicant's payment habits
- **Capacity**: ability to make payments and continue making payments on existing obligations
- **Character**: indicators of the applicant's trustworthiness and stability (length of employment, time at current residence, lawsuits and bankruptcy filings)

- Guidelines: debt ratio should not exceed 36%
 - Take total debt payments for 1 month and divide by gross income for 1 month
 - Debt includes: mortgage payments, school loans, car payments, credit cards, etc.
 - Does not include regular monthly bills such as utilities, phone, gas, electricity, etc.

- Calculate debt ratio example: Mortgage (\$1000), car payment (\$350), minimum payment on credit cards (\$200); gross monthly income (\$4900)
- Total debt = \$1550 Total income = \$4900
- $\$1550 / \$4900 = .318 = 32\%$
- Debt ratio is okay

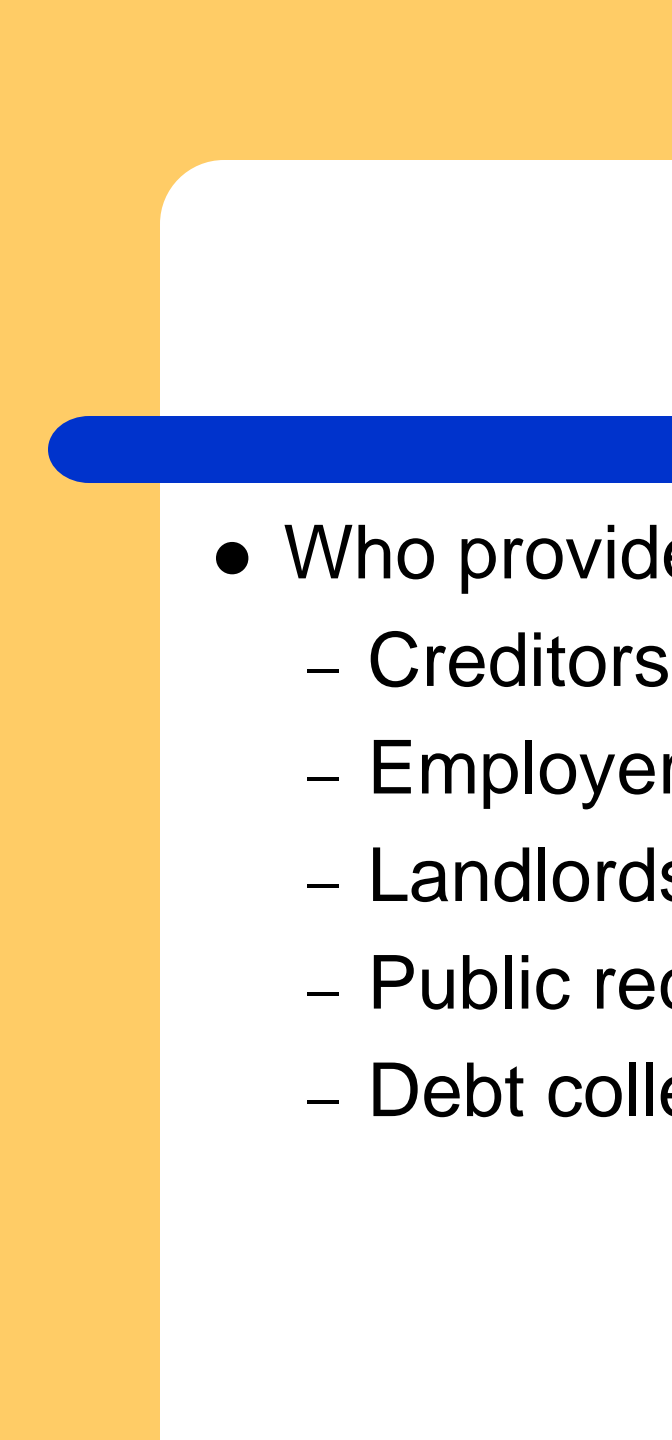
Ways to establish a credit record:

- Checking account – do not overdraw funds; make regular deposits
- Savings account – make regular deposits
- Pay bills on time
- Credit card – charge some purchases and pay ENTIRE bill
- Get a small loan (parents may need to cosign) – pay off accordingly
- Pay rent on time (can use them as references)

Credit Bureaus

- What are credit bureaus?
 - Store information about consumers and how they handle financial responsibility
 - Private firms which collect data from creditors information on their experiences with borrowers
 - Establish and maintain credit files on consumers
 - Provide credit reports to consumers or businesses

- Why have credit bureaus?
 - Saves time
 - Saves money
 - Able to obtain credit quickly and easily
- Three largest credit bureaus:
 - Experian
 - TransUnion
 - Equifax

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- Who provides information to credit bureaus?
 - Creditors
 - Employers
 - Landlords
 - Public records
 - Debt collection agencies

Credit records

- Information about consumers regarding their financial responsibility
- “Financial reputation”
- Contains your **credit score** – a score given to consumers based on the information contained in the credit report: range of 300 – 850 (850 is the best)