

PROLOGUE TO THE MANAGEMENT OF CONSUMER CREDIT

Marlene and I went to Brandsmart USA in Florida where we purchased two large LG TV's for our new home.

We placed the charge of \$2,700 on our Capital One credit card and agreed that we would pay 10% of the amount every month.

Here is the first bill !

MANAGEMENT OF CONSUMER CREDIT



Account Number: 4003-4470-0645-5101

Due Date	New Balance	Minimum Payment	Amount Enclosed
Oct 20, 2010	\$2,763.40	\$27.00	.

PLEASE PAY AT LEAST
THIS AMOUNT

ELLIOTT P SMITH
250 HAMMOND PKWY APT 1701S
CHESTNUT HILL, MA 02467-1540

77502
F105



**GO GREEN.
SAVE GREEN!**

Pay online and save
money on stamps.

Sign up at www.capitalone.com



400008

Capital One Bank (USA), N.A.
P.O. Box 71063
Charlotte, NC 28272-1063



Please make checks payable to Capital One Bank (USA), N.A. and mail with this coupon in the enclosed envelope.

At 8%/year, it will take approximately 14 1/2 years to pay off the charge and I will have paid back almost \$4,600 (or \$1,900 in interest).

MANAGEMENT OF CONSUMER CREDIT

		Original	Interest	Monthly	New
<u>T</u>		<u>Balance</u>	<u>@ 8/yr</u>	<u>Payment</u>	<u>Balance</u>
1		\$ 2,763.40	\$18.42	\$ 27.00	\$ 2,754.82
12		2,665.84	17.77	27.00	2,656.61
24		2,550.96	17.01	27.00	2,540.96
36		2,426.54	16.18	27.00	2,415.71
48		2,291.79	15.28	27.00	2,280.07
60		2,145.86	14.31	27.00	2,133.16
72		1,987.82	13.25	27.00	1,974.07
84		1,816.66	12.11	27.00	1,801.77
96		1,631.29	10.88	27.00	1,615.16
108		1,430.54	9.54	27.00	1,413.07
120		1,213.12	8.09	27.00	1,194.21
132		977.66	6.52	27.00	957.18
144		722.66	4.82	27.00	700.48
156		446.49	2.98	27.00	422.47
168		147.41	0.98	27.00	121.39
173		15.57	0.10	15.68	(0.00)

MANAGEMENT OF CONSUMER CREDIT

The moral of the story: Avoid Making Minimum Payments!

On average, abiding by the “minimum payment could take more than eight years to repay.

Be wary of “payment skipping” interest still accrues

MANAGEMENT OF CONSUMER CREDIT

MANAGEMENT OF CONSUMER CREDIT

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View credit as a privilege and comply with the conditions of its usage with diligence and respect.

MANAGEMENT OF CONSUMER CREDIT

Key Advice:

- **Approach all credit usage as an opportunity to build an excellent credit history**
 - **It will allow you to obtain credit in the future at more favorable rates**
 - **Comparison shop for credit cards to ensure that you open accounts with the lowest available rate**
 - **Avoid carrying outstanding balances, but if you do, discipline yourself to pay it off within months, not years.**
 - **Periodically obtain your credit bureau report.**
 - **If errors, take immediate steps to correct;**
 - **Maintain receipts to confirm accuracy on the billing statement**
 - **Avoid high-cost credit card add-ons such as insurance, credit card loss, etc.**
 - **Often, the better credit card company will include them at no charge.**

MANAGEMENT OF CONSUMER CREDIT

FIVE "C's" of CREDIT

- 1) Character – will you repay the loan?
 - a. Do you have a positive attitude towards the management of credit
 - b. Have you used credit before
 - c. Do you pay your bills on time
 - d. Do you live within your means
- 2) Capacity – can you repay the loan
 - a. Your salary and occupation
 - b. How reliable is your income
 - c. Any other sources of income
- 3) Capital – what are your assets and net worth
 - d. What assets do you own
 - e. How much do you owe
 - f. What is your net worth
- 4) Collateral – what if you don't repay the loan
 - g. What assets do you own that will secure the loan
 - h. What sources do you have besides income
- 5) Conditions – what general economic conditions can affect your loan repayment
 - a. How secure is your job
 - b. How secure is the firm you work for



MANAGEMENT OF CONSUMER CREDIT

ADVANTAGES OF CONSUMER CREDIT

- 1) Item of substantial value need not be deferred!!
 - a. Car
 - b. Boat
 - c. Home
- 2) Preservation of savings
- 3) Pay as you enjoy!!! (Early consumption)
- 4) Convenient record keeping
- 5) Emergencies
- 6) Grace period for "no charge" borrowing Let's talk about +’s and –‘s)

DISADVANTAGES OF CONSUMER CREDIT

- 1) Tendency to overspend
- 2) Too much future income is encumbered
- 3) Credit cost money....!
Cost of credit.....10% ~ 25%!!!
- 4) Possible surrender of asset being collateralized if loan is defaulted

MANAGEMENT OF CONSUMER CREDIT

An Overview:

- 1) Temptations for abuse have never been greater!!!!
- 2) Success in Managing Consumer Credit is one approach to financial independence
- 3) Forms Of Consumer Credit

- 1) Service Credit - Utilities)
- 2) Cash Loans)
- 3) Installment Loans)
- 4) Overdraft accounts)
- 5) Bank Cards)
- 6) Retail charge accounts)
- 7) Travel and Entertainment cards)
- 8) Oil credit cards)

**CONSUMPTION NOW WITH
COMMITMENT TO PAY WITH
FUTURE INCOME!**

MANAGEMENT OF CONSUMER CREDIT

DEBT PAYMENT LIMITS AS A PERCENT OF DISPOSABLE INCOME

- Up to 10%: Safe limits; little debt pressure and additional debt can be undertaken but cautiously
- 11% ~ 15%: is probably safe, but borrower does feel pressure; no additional debt suggested
- 16% ~ 20%: is fully extended and the “max”; hopefully no emergencies; pushing the limits
- 21% ~ 25%: is overextended; borrower worries; seek financial advice
- 26% and more: disastrous and borrower may feel desperate; bankruptcy is imminent

MANAGING CREDIT

- 1) Debt Payments-to-Disposable Income Method (*see table to follow*)
- 2) Ratio of Debt to Equity...best to keep below 1:1 (safe level is about 1/3:1)
- 3) Continuous Debt....can consumer debt be paid off in three years

			John and Mary Smith						
			Personal Balance Sheet						
			March 20, 2013						
				Present			Acquire		
				<u>Situation</u>			<u>Vehicle</u>		
ASSETS:									
Liquid Assets:									
	Cash on Hand			\$500			\$500		
	Checking Account			3,500			500		
	Savings Account			1,000			1,000		
	Total Liquid Assets:			<u>5,000</u>			<u>2,000</u>		
	Home			0			0		
	Automobile			5,000			20,000		
	Furniture			1,000			1,000		
	Total Household Assets			<u>6,000</u>			<u>21,000</u>		
Investment Assets									
	Stocks			3,000			3,000		
	Total Investment Assets								
	Total Assets			<u>\$14,000</u>			<u>\$26,000</u>		
LIABILITIES AND NET WORTH									
Current Liabilities:									
	Credit Card Balance			\$2,000			\$2,000		
	Total Current Liabilities:			<u>\$2,000</u>			<u>\$2,000</u>		
Long-Term Liabilities:									
	Mortgage			0			0		
	Car Loan			0			12,000		
	Total Long-Term Liabilities:			<u>0</u>			<u>12,000</u>		
	Total Liabilities:			<u>2,000</u>			<u>14,000</u>		
	Net Worth:			<u>\$12,000</u>			<u>\$12,000</u>		
Notes:									
	Liquidty Ratio			3:1			1:1		
	Debt to Assets Ratio			14%			54%		

MANAGEMENT OF CONSUMER CREDIT

Calculating Debt Payments-to-Take Home Pay

Monthly Gross Income		\$6,200
Less:		
All income taxes withheld	885	
Social Security	474	
IRA Contribution	<u>333</u>	<u>1,573</u>
Monthly take-home pay		<u>\$4,627</u>
Monthly installment credit payments:		
MasterCard	320	
Education Loan	---	
Auto Loan Repayment	<u>410</u>	<u>\$730</u>
Debt Payments-to-Take Home Pay		16%

Pushing the limit and hopefully no emergencies

MANAGEMENT OF CONSUMER CREDIT

SOURCES OF CONSUMER CREDIT

- 1) Commercial Banks....a variety of loans
- 2) Credit Unions
 - a. Passbook...Mortgages...Auto loans...home improvement & home equity
- 3) Savings and Loan Assn.
 - a. Principally home mortgages
 - b. Home equity and improvement
 - c. Car loans
- 4) Consumer Finance Company...usually when credit is POOR
 - a. High rate of interest
 - b. Most definitely collateralizes assets
- 5) Life Insurance Companies
 - a. Borrow on Cash Surrender Value - easy terms and low interest
 - b. On death, unpaid balance is deducted from proceeds
- 6) Sales Finance Co's.....WATCH OUT!!!!
 - a. Watch for.....
 - 1) Balloon payment....final payment can be much higher
.....requires refinancing
 - 2) Acceleration clause....missed payment requires payment in full
 - 3) Add-on clause...subsequent purchases encumbers all items purchased
 - 4) Could have wages assigned (garnished)



CREDIT REPORTS

CREDIT REPORT FACTS

- Record of your credit payment history
- Illustrates the amount you have borrowed in credit cards and loans and your timeliness of payment
- Contains identifying information
- Used to determine creditworthiness

CREDIT REPORT FACTS

Basic Credit Risk Levels:

Low (726-830):

Likely to get loans and good rates.

Medium (626 - 699):

Can still receive credit but at higher rates.

High (330 - 550):

Less likely to get credit and often pay very high rates.



ANATOMY OF A CREDIT REPORT

Section 1: Personal Identification Information

Section 2: Public Record Information

Section 3: Collection Agency Account Information

Section 4: Credit Account Information

Section 5: Companies Requesting your Credit File

HOW TO OBTAIN YOUR CREDIT REPORT

Credit Agencies:

- ✕ Equifax www.equifax.com
- ✕ Experian www.experian.com
- ✕ Trans Union www.transunion.com

- ✕ One free report from each agency every 12 months:
 - ✕ www.annualcreditreport.com

- ✕ ** do not use www.freecreditreport.com ***

CREDIT SCORES

ESTABLISHING GOOD CREDIT

- ✖ Pay your bills on time
- ✖ Establish credit early
- ✖ Don't max out your account limits
- ✖ Don't apply for too much credit in a short period of time
- ✖ Fill out applications uniformly
- ✖ Check your credit report annually or 4 months before major purchase

CREDIT SCORE

- Reflection of the information on your credit report
- Formula developed by Fair and Isaac Corporation (FICO)
- Scores range from 300-850
- Average score is 720
- The lower the score, the greater the risk it is to lend you money

MANAGEMENT OF CONSUMER CREDIT

How to calculate your credit score

Payment history – 35%

Lenders are most concerned about whether or not you pay your bills. The best indicator of this is how you've paid your bills in the past.

Debt Level – 30%

The amount of debt you have in comparison to your credit limits is known as credit utilization. The higher your credit utilization – the closer you are to your limits – the lower your credit score will be. Keep your credit card balances at about 30% of your credit limit or less.

Length of Credit History – 15%

Having a longer credit history is favorable because it gives more information about your spending habits. It's good to leave open the accounts that you've had for a long time.

Inquiries – 10%

Each time you make an application for credit, an inquiry is added to your credit report. Too many applications for credit can mean that you are taking on a lot of debt or that you are in some kind of financial trouble.

Mix of credit – 10%

Having different kinds of accounts is favorable because it shows that you have experience managing a mix of credit.

REQUIREMENTS FOR THE PERFECT SCORE

- Having paid all bills on time during the past seven years
- Having a minimum of 30 years of credit use
- Having between four and six revolving credit accounts



THE COST OF CREDIT

MANAGEMENT OF CONSUMER CREDIT

THE COST OF CREDIT

1) Annual percentage rate (APR)

a. Simple Interest on Lump sum payment

Divide annual interest by average loan balance

a. Borrow \$2,000 for 3 years

b. Annual cost of interest is \$200

c. $APR = 200 \div 2000 = 10\%$

b. Simple Interest on Installment Loans

1) Interest is calculated on unpaid balance

a. Borrow \$2,000 for 3 years (payable annually)

c. Stated interest rate is 10%

d. $APR = 10\%$

e. $FVF_1 = 1.10$

$FVF_2 = (1.10) \times (1.10) = 1.21$

$FVF_3 = (1.10) \times (1.10) \times (1.10) = 1.331$

f. Divide into 1 =	$1 \div 1.100$	= .9090
	$1 \div 1.210$	= .8264
	$1 \div 1.331$	= <u>.7513</u>
		2.4867

g. Divide face amount of loan by "Sum"

$\$2,000 \div 2.4867 = \804.28 annual payment

#	<u>Loan Balance</u>	<u>Payment</u>	<u>Interest</u>	<u>Principal</u>	<u>New Balance</u>
1	\$2,000.00	804.28	200.00	604.28	1,395.72
2	1,395.72	804.28	139.57	664.71	731.01
3	731.01	804.28	73.10	731.18	—

MANAGEMENT OF CONSUMER CREDIT

Monthly Installment Payment (Principal and Interest) Required to Pay \$1,000

		Annual Percentage Rate								
Terms of Installments		4%	6%	8%	10%	12%	14%	16%	18%	20%
1 year	(12 months)	85.15	86.07	86.99	87.92	88.85	89.79	90.73	91.68	92.63
2 years	(24 months)	43.42	44.32	45.23	46.14	47.07	48.01	48.96	49.92	50.90
3 years	(36 months)	29.52	30.42	31.34	32.27	33.21	34.18	35.16	36.15	37.16
4 years	(48 months)	22.58	23.49	24.41	25.36	26.33	27.33	28.34	29.37	30.43
5 years	(60 months)	18.42	19.33	20.28	21.25	22.24	23.27	24.32	25.39	26.49
6 years	(72 months)	15.64	16.57	17.53	18.53	19.55	20.61	21.69	22.80	23.95
7 years	(84 months)	13.67	14.61	15.59	16.60	17.65	18.74	19.86	21.02	22.21
8 years	(96 months)	12.19	13.14	14.14	15.17	16.25	17.37	18.53	19.72	20.95
9 years	(108 months)	11.04	12.01	13.02	14.08	15.18	16.33	17.53	18.76	20.03
10 years	(120 months)	10.12	11.10	12.13	13.22	14.35	15.53	16.75	18.02	19.32

To illustrate, assume you want to know how much the monthly payments would be to finance an automobile loan of \$15,000 at 10 percent for 5 years. To repay \$1000, the figure is \$21.25; therefore, multiply by 15 (for \$15,000) to determine that \$318.75 is required for 60 months of payments. When using amounts greater or less than \$1,000, convert using decimals. For example, a loan of \$750 at 12 percent for 3 years would be calculated as follows: $\$33.21 \times 75\% = \24.91

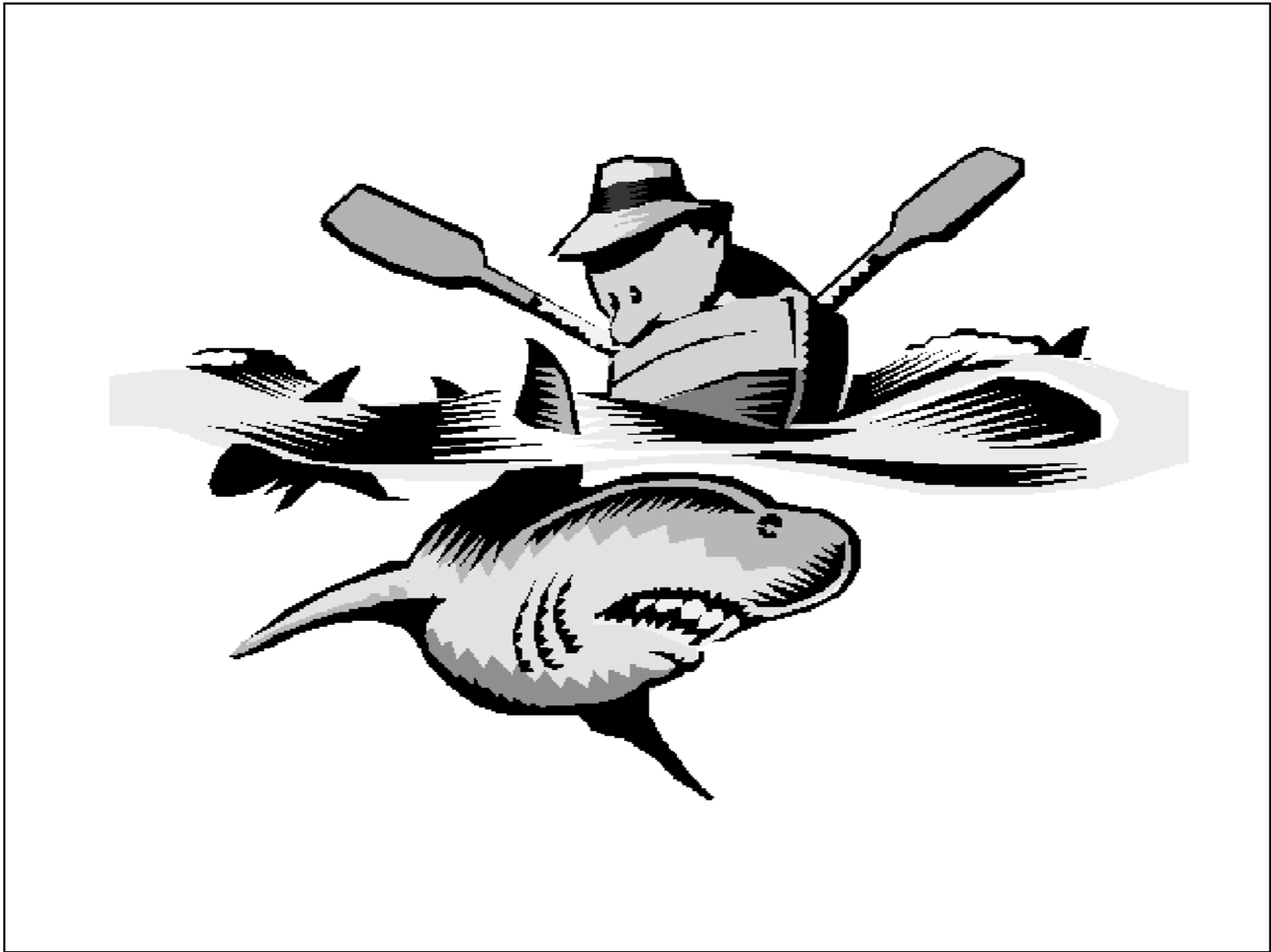
Assuming you conformed to the "minimum payment" noted on your credit card statement, to determine the approximate duration of your payments, first go to the column that represents the annual rate of interest charged by the credit card company; next, for amounts greater or less than \$1,000, convert using decimals. For example, a credit card statement showing a balance of \$2,140, with an annual rate of interest of 12%, might require a monthly minimum payment of \$39. Dividing the \$39 by 2.14, arrives at \$18.22, as the adjusted monthly payment. Under the 12% column, it would take between six to seven years (closer to seven) to pay off your credit card statement, WITHOUT any consideration to new purchases, annual charges, etc. And the TOTAL amount of your payments over the six to seven year period would amount to OVER \$3,000.

MANAGEMENT OF CONSUMER CREDIT

So, suppose you're carrying an \$8,900 balance at 14.94 percent and paying approximately \$125 per month, you'll be paying off your credit card for nearly 15 years and forking over \$13,000 in interest if you pay just the minimum every month. If you manage to pay a fixed \$350 every month, you can rid yourself of debt in two years and seven months, paying only \$1,950 in interest.

Show HP12C Calculation





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QUESTIONS?

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