Successful Start and the Office of Student Services Present:

CREDIT 101: UNDERSTANDING CREDIT
What is credit?
Credit Cards
  + Rewards
  + Risks
  + Terms
Interest Rates
Using credit successfully
WHAT IS CREDIT?

- **Borrowing Money**
  - Paying interest
  - Paying fees

- **Revolving**
  - Can repeatedly borrow up to a set amount
  - Minimum payments
  - Possible fees

- **A credit card is a loan**
When the bill is paid off, will:

- I remember what I bought?
- The item have value?
- The total cost be worth it? (item + interest)

Yes to all is a good use of credit

No to one, consider paying cash
CREDIT CARD BENEFITS

- Emergency
- Convenient
- Internet purchases
- Car rental
- Safer than carrying cash
- DVD rental membership
- Travel & cash-back rewards
REWARDS OF WISE CREDIT USE

- Easier to rent an apartment
- Easier to buy a car
- Increases job opportunities
- Better interest rates
- Saves money
- Helps establish good credit
CREDIT CARD RISKS

- Fees
- High interest rates
- Short or no grace period
- Impulse purchases
- Emotional spending
- Bad credit
- Confusing credit terms
READING A CREDIT CARD OFFER

- Annual Percentage Rate (APRs)
- Other APRs
  - Balance transfer
  - Cash advance
  - Default
- Variable/fixed interest rates
READING A CREDIT CARD OFFER

- Grace period
- Method for computing interest charges
- Fees
  - Annual
  - Cash advance
  - Over limit
  - Late
  - Others
- Additional fine print
**Annual Percentage Rate (APR)**

- Annual basis
- Up-front charges
  - Origination fees on non-credit card loans
- Compounding frequency

**Can make shopping easier**

- Price tag
INTEREST RATE

- A charge for a loan
  + Shown as a percent of borrowed amount
- How payment is applied for most loans
  + Fees
  + Interest
    - Lowest interest rate balance
    - Higher interest rate balance
  + Principal
**FIXED OR VARIABLE RATE**

- **Fixed Rate**
  - Rate doesn’t change
  - Risk is on the lender when rates increase

- **Variable Rate**
  - Rate changes
  - Risk is on the borrower when rates increase
Determining Interest Rates

- Index + Margin = Rate
- Index (cost of funds) 4%
  - T-bill, LIBOR, Prime +
- Margin (covers expenses) 6%
- Rate the borrower pays 10%
ADJUSTMENT PERIOD

- Credit card rates change frequently
  - Annually, quarterly, monthly
- Purpose
  - Easier budgeting for borrower
  - Maintain lenders’ margin
GRACE PERIOD

- Number of days without interest
- Between 20 days & one month
- Conditions
  + Pay new balance in full for billing period
  + Before due date
- Making minimum payments
  + No grace period
  + Interest charged from purchase date
CALCULATING INTEREST CHANGES

- Average Daily (most common)
  - Outstanding Balance ÷ Number of Days

- Two-Cycle (most expensive)
  - Outstanding Balance for Last Month and This Month ÷ Number of Days

- Adjusted
  - Balance at Beginning of Cycle − Payments During Cycle

- Previous
  - Interest is Based on Balance at Beginning of Cycle
TYPES OF FEES

- Late
- Annual
- ATM
- Over the Limit
- Cash Advance
- Balance Transfer
- High Interest Rate
CASH ADVANCE FEE

- On a $20 Cash Advance, you’ll be charged:
  - 3% of amount, but
    - No less than $5
    - Or more than $50
  - A $5 fee on a $20 cash advance is a hefty 25%!
**The Fine Print**

- Raising your rate to 24.99% or higher
  - Fail to pay on time
  - Fail to pay another creditor on time
  - Bounce a check for a credit card payment
  - Exceed your credit limit
CREDIT CARD TEMPTATIONS

- **Bonuses**
  - Free gifts
  - Miles/points
  - Cash back
  - Car discounts
  - Merchandise discounts

- **Teasers**
  - Introductory rates
  - Balance transfers
  - Limited-time offers
## Paying for Free Gifts

<table>
<thead>
<tr>
<th></th>
<th>Est. Value</th>
<th>Cash Advance Fee</th>
<th>Late Fee</th>
<th>Over Limit Fee</th>
<th>Annual Fee</th>
<th>Annual Interest on $1,000</th>
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<tbody>
<tr>
<td>Gift</td>
<td>$5</td>
<td>$30</td>
<td>$29</td>
<td>$29</td>
<td>$0</td>
<td>$149-$229</td>
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<tr>
<td>Cash Back</td>
<td>$2</td>
<td>$30</td>
<td>$29</td>
<td>$29</td>
<td>$0</td>
<td>$149-$229</td>
</tr>
<tr>
<td>Airline Miles</td>
<td>$12</td>
<td>$20</td>
<td>$29</td>
<td>$29</td>
<td>$39</td>
<td>$154-$229</td>
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<tr>
<td>Shopping</td>
<td>$50</td>
<td>$30</td>
<td>$29</td>
<td>$29</td>
<td>$0</td>
<td>$189-$240</td>
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</table>
### CHANGING HABITS FOR ONE WEEK

<table>
<thead>
<tr>
<th>Expense</th>
<th>Cost</th>
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<tbody>
<tr>
<td>Morning Coffee</td>
<td>$20/week</td>
</tr>
<tr>
<td>Eating Out</td>
<td>$35/week</td>
</tr>
<tr>
<td>Night Out with the Friends</td>
<td>$45/week</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$100/week</strong></td>
</tr>
</tbody>
</table>
## True Cost of Charging $100

<table>
<thead>
<tr>
<th>End of Period</th>
<th>Balance</th>
<th>Minimum Payment</th>
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<tbody>
<tr>
<td>1st Month</td>
<td>$400</td>
<td>$12</td>
</tr>
<tr>
<td>1st Year</td>
<td>$4,713</td>
<td>$146</td>
</tr>
<tr>
<td>5 Years</td>
<td>$2,232</td>
<td>$69</td>
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<tr>
<td>10 Years</td>
<td>$877</td>
<td>$21</td>
</tr>
<tr>
<td>19 Years</td>
<td>$7</td>
<td>$7</td>
</tr>
</tbody>
</table>

Assumes $100 weekly charge for 52 weeks, then the borrower stops charging. Payments based on 3% minimum payment with an interest rate of 18%. No additional charges are made in years 2-19.
CREDIT CARD STATEMENT

- Outstanding Balance
- Minimum Repayment Amount
- Payment Date
- Annual Percentage Rate (APR)
- Rates, Fees & Charges
CONVENIENT ALTERNATIVES

- Cash
- Checks
- Debit & Check Cards
- ATM Cards
  - Track expenses and avoid usage fees
- Loan
  - Usually less expensive than a credit card
  - A fixed repayment term
USING CREDIT SUCCESSFULLY

- Identify your spending habits
- Understand the fine print
- Manage credit wisely
- Limit yourself to one or two cards
- Pay balance in full each month
- Ask for help at the first sign of trouble