FE-260 (Revised)

Super charge

Credit – Using It Wisely

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Establishing a good credit rating is important for everyone.

Buying on credit enables more people than ever to buy goods and services when they want them. The ratio of debt (nonmortgage) to disposable income in American families hit an all-time high in the ’80s (nearly 24 percent), then leveled off during the next 10 years before climbing again since 1993. In 2004, the average debt ratio was a little more than 14 percent.

Many experts recommend that a maximum of 20 percent of family take-home income be committed to consumer debt. Limiting consumer debt to 15 percent of family income may prevent problems for families who are at risk of large, unforeseen expenses – for example, families with little or no medical expense coverage.

The Credit Rating

A credit rating is a way for lenders to rate the potential customer as a credit risk. Potential creditors have access to records and other information concerning how you have managed your financial obligations.

Who Needs a Credit Rating?

Establishing a good credit rating in his or her own name, regardless of marital status, is important for everyone. Divorce or separation, or the severe illness or death of a spouse, can cause severe financial problems for a person who has no individual credit rating.

Prior to the 1975 Equal Credit Opportunity Act, married women often could not get credit. A family’s credit history was reported only in the husband’s name.

Today a married woman can and should get credit in her own name and also have her credit history reported in her own name. Everyone, however, must take responsibility for learning his or her credit rights, and for establishing his or her own credit identity.

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Your Credit Score

Your credit score is a figure – usually between 300 and 850 – that reflects your credit history. It indicates whether you're a good candidate for a loan.

Lenders also use your score to determine the interest rate and terms of your loan. The lower your score, the harder getting credit will be.

Several different companies calculate credit scores. However, the Fair Isaac Corp. developed the most commonly used score, called the FICO score. Even though creditors have had access to credit scores for several years, consumers have not been able to view their score until 2001. Consumers having the right to see their scores prevents lenders from misleading potential borrowers into believing the consumers have a lower score. Now consumers can double-check their score so they receive a fair interest rate.

Scores in the 300s are the worst. Even if you score in the 400s and 500s, you'll be charged a higher interest rate and will need a larger down payment than someone with a higher credit score. An 800-plus score easily will qualify you for a loan with the best interest rate. Most people score in the 600s and 700s.

If you're planning to make a large purchase on credit, check your credit score six to 12 months in advance so you can take steps to raise your score.

To determine your score, the FICO system uses your credit history in five major areas: payment history, amount owed, length of credit history, new credit and types of credit in use.

Your **payment history** has the largest impact on your score; your credit account payments determine 35 percent of your score. If you pay your bills on time and don't miss payments, your score will be higher. Recent payment activity counts more than your payment history of years ago. A 90-day late payment that you made in the last 30 days affects your score more than a 120-day late payment five years ago. The score reflects how late the payment was, how recently it occurred, how much you owed and how many payments were late. If you resume on-time payments after a string of late payments, your score gradually will increase. Your score will be higher if you have no late payment on most or all of your accounts.

The **amount you owe** determines 30 percent of your credit score. Even if you pay off your credit card bills every month, the balance of your last statement may be reflected in your credit report that influences your credit score. Your score is reduced if you "max out" or carry large unpaid balances on several credit cards. That makes you look overextended. Carrying a small balance and paying it off demonstrates that you can manage credit responsibly. You can increase your score by getting credit only when you need it and by staying under your credit limits. Paying off debt is better than transferring balances from one card to another. Closing unused credit card accounts won't raise your credit score.

Neither will opening several new accounts to try to increase your available credit.

The **length of time** you have built a credit history contributes 15 percent of your credit score. The longer you have used credit, the higher your score. The score takes into account the age of your oldest account and an average age of all accounts. If you have just opened several accounts, the average age will go down, which will lower your credit score. This is a good reason to resist the offers of "10 percent off of all purchases today if you open a credit account with our store."

Ten percent of your credit score is based on **recent requests for credit**. When you apply for credit, the lender checks your credit report and credit score.

This is known as an inquiry. Voluntary and involuntary are the two types of inquiries.

- **Voluntary** is when you solicit the request for credit and it shows up on your credit report.
- **Involuntary** inquiries are when you received offers for credit, usually in the mail, and

you have been "preapproved" for credit. These do not show up on your credit report that is sent to potential lenders.

The number and type of new accounts will influence your credit score. The length of time since you opened a new account also is considered. Multiple requests for credit, especially within the past year, can reduce your credit score. If you have credit available to you that you are not using, your score will be higher.

The **types of lenders** you do business with determine the last 10 percent of your credit score. Your score will be higher if your borrowing is from a cross section of reputable lending establishments – credit cards, retail accounts, installment loans, finance company accounts, mortgage loans and so forth – but do not open accounts just to achieve variety in your accounts.

Your score won't be affected if you ask for your own credit report. Nor will it be damaged if firms ask about you before offering you credit for which you didn't apply. But if you apply for several loans or credit cards at once, leading to numerous inquires from lenders, your credit score can suffer indeed.

An exception is shopping around for the best loan when you're buying a car or home; the inquiries these lenders make within a two-week period are counted as one.

Your Credit Report

A recent amendment to the federal Fair Credit Reporting Act (FCRA) requires each of the nationwide consumer reporting companies to provide you with a free copy of your credit report, at your request, once every 12 months. The three nationwide consumer reporting companies have set up one central Web site, toll-free telephone number and mailing address through which you can order your free annual report.

To order, click on *www.annualcreditreport.com*, call (877) 322-8228, or complete the Annual Credit Report Request Form (available at *www.ftc.gov/bcp/conline/includerequestformfinal.pdf#search=%22Annual%20Credit%20Report%20Request%20Form%20%22)* and mail it to: Annual Credit Report Request Service, P.O. Box 105281, Atlanta, GA 30348-5281.
The form is on the back of this publication; or you can print it from *www.ftc.gov/credit* .

Do not contact the three nationwide consumer reporting companies individually.
They are providing free annual credit reports only through *www.annualcreditreport.com*, (877) 322-8228 and Annual Credit Report Request Service, P.O. Box 105281, Atlanta, GA 30348-5281.

You may order **your reports** from each of the three nationwide consumer reporting companies at the same time, or you can order from only one or two. Experts recommend ordering reports (one at a time) in three-month intervals.
The law allows you to order one free copy from each of the nationwide consumer reporting companies every 12 months.

You will need to provide your name, address, Social Security number and date of birth. If you have moved in the last two years, you may have to provide your previous address. To maintain the security of your file, each nationwide consumer reporting company may ask you for some information that only you would know, such as the amount of your monthly mortgage payment. Each company may ask you for different information because the information each has in your file may come from different sources.

Information in your credit file remains on record for seven years, with the exception of bankruptcy, which is on file for 10 years. If you disagree with any information contained in your file, the credit bureau will recheck any entry you question. If the entry is found to be incorrect or cannot be verified, it will be deleted from your file and you may request that the credit bureau notify anyone who has received credit reports on you within the last six months. If you and the creditor cannot agree on a portion of your credit history, or if you would like the opportunity to explain the extenuating circumstances, you can have your written version of the facts (100-word maximum) included as part of your credit record.

How Do You Rate as a Borrower?

Store credit managers and lending agency officers want to be certain you will repay any loans or credit they give you. The decision whether to give you credit or a loan is based on your ability and willingness to repay the debt and, in some cases, the security you can offer to protect the loan. These considerations are called the three C's of credit –

Capacity
Character
Capital

Capacity refers to your current income and expected future income. **Character** refers to your reputation for honesty and reliability, as well as your record of responsibility. **Capital** refers to things of monetary value that you own.

Lenders use these and other factors (such as the state of the economy) in deciding whether to grant you credit or a loan. Some lenders set higher standards than others. Some simply do not offer certain kinds of credit. In short, different lenders may reach different conclusions based on the same set of facts. One may find you an acceptable risk while another may decide to deny you the credit you request.

Establishing a Credit Rating

You have many ways to establish and maintain a credit rating. Some possibilities are:

- Take a full- or part-time job. You may need to work three to 13 months before qualifying for a cash loan or other types of credit.
- Open a checking and savings account in your own name.
- Apply in your own name for an "overdraft" account from your bank. Whether or not you use the account, the fact that you have been granted one will be recorded in your credit file and will enhance your credit rating. However, the bank charges an additional fee for overdrafts.
- Apply for a single-purpose credit card, such as a department store or gasoline credit card, even if you need a co-signer. Later you can put the account in your own name.
- Apply for a multipurpose credit card, such as VISA, MasterCard, American Express or Discover. Possession of your own multipurpose credit card will improve your chances of being accepted for other types of credit.
- Borrow cash from a bank or credit union to make a purchase. If you borrow on an installment plan, make a large down payment on whatever you are purchasing, then pay off the loan according to contract terms.
- Finance the purchase of furniture, a car or a major appliance with an installment plan through the dealer. You probably will pay a higher rate of interest than if you borrowed from a bank or credit union, but you will gain the convenience of not having to arrange for financing. In a situation where the dealer offers low (or no) interest rates, be aware that the costs of credit have been added to the price of the goods or service.
- Be certain to make payments on time. That will help you keep a good credit rating and obtain new credit.

Shopping for Credit

Often people do not take the time to shop for credit. Your choice of credit can make a difference of hundreds or even thousands of dollars during the life of a loan.

Shopping for a loan

If you need a large loan for a major purchase, such as a car or home, shopping around for the best value will pay off. (Extension publication FE-243, "Shopping for a New or Reduced-term Mortgage," may be helpful if you are planning to purchase a home.)

First, establish the amount you need to borrow. Next, check your financial situation to determine what you can afford for the monthly repayment. You might begin to shop for credit with your financial institution or one that family or friends recommend. When checking with or visiting each institution, be sure to note the different rates and terms available. Make sure you compare the annual percentage rates, terms of the loan (including such things as penalties for early repayment) and the expected turnaround time on your loan application.

Also consider the quality of service that the institution provides. Ask questions about anything you are unsure of before you sign.

Shopping for a credit card

Just like other loan rates and terms, credit card rates and features vary.

Determining which card is right for you depends on your lifestyle and values, and on how you plan to use your credit card. Classify yourself as one of these three types of credit card holders:

- **The Identification User**
  This credit card holder generally uses the card for identification in cashing checks, making hotel reservations and renting cars. Since this user does not carry over payments, the APR (Annual Percentage Rate) charged is not the most important feature in selecting a card. More important considerations are the universal acceptance of the card and the annual fee charged. Annual fees can range from $12 to $50 or more. Many cards are available with no annual fee.

- **The Nonrevolver**
  This person pays off the balance in full when due. This user, like the identification user, doesn't consider the annual percentage rate the most important characteristic. Instead, greater attention should be given to the "grace period," which is the time (usually 21 to 30 days) between when a bill is sent out and the interest is charged on the unpaid balance. The limit on the credit amount also may be of importance if the card will be used for vacation or business travel. Other fees charged, such as transaction charges, late charges and the annual fee, also are of importance.

- **The Revolving Credit User**
  The annual percentage rate usually is the most important factor for the credit card user who doesn't pay off the monthly balance and carries a balance from month to month. While bank card average percentage rates can vary from 12 percent to 22 percent or more, you may be able to find lower rates. Another important consideration is how interest is calculated. For example, some cards deduct payments made during the month when figuring the average daily balance and other cards do not. Cards also vary by the minimum monthly payment required, which often is calculated as a percentage of the outstanding balance.

Other credit card features

Other credit card features also are available. These include rebates or discounts on purchases made with the card, warranties on credit card purchases, the ability to obtain cash 24 hour a day by using the card at an ATM (Automated Teller Machine), travel insurance, travel and reservation service, shoppers guides and extra cards for family members.

How Much Can Be Borrowed Safely?

No hard-and-fast rules exist for determining how much credit is too much because every individual's situation is different. If you are using credit to purchase durable goods, you might ask yourself, "Will I still be enjoying this item when I make the last payment?" If you find yourself using credit to buy disposable goods, such as groceries, eating out and vacations, you may find yourself over your head in credit problems someday.

Several factors affect the amount you are able to borrow and the amount of debt you can assume safely. These include not only your current and expected future income, but also your assets, provisions you have made for unexpected expenses, the number of dependents you must support, your housing expenses, your other financial commitments and the total amount of your debts.

Facing a Financial Crisis

A sudden accident, illness or loss of job may create a situation that threatens even the best-laid financial plans. If you find yourself over your head in debt, you have some alternate measures to consider before filing for bankruptcy. You may be able to work things out directly with your creditors. You may be able to find additional income, cut back on expenses or change your lifestyle to handle the crisis.

The National Foundation for Consumer Credit, (800) 388-2227, has information about nonprofit consumer credit counseling services.

In North Dakota, services are available through CCCS (Consumer Credit Counseling Services) of the Village Family Service Center, (800) 450-4019. Counseling is available in person, on the phone or online *(www.helpwithmoney.org)*.

Protect Your Identity

Identity theft involves someone else using your personal information to create fraudulent accounts, charge items to another person's existing accounts, or even get a job. To minimize the risks, manage your personal information wisely and cautiously. Here are some ways to protect yourself from identity theft:

- Before you reveal any personal identifying information, find out how it will be used and whether it will be shared.
- Pay attention to your billing cycles. Follow up with creditors if your bills don't arrive on time.
- Guard your mail from theft. Deposit outgoing mail in post office collection boxes or at your local post office. Promptly remove mail from your mailbox after it has been delivered. If you're planning to be away from home and can't pick up your mail, call the U.S. Postal Service toll-free at (800) 275-8777 or visit *www.usps.gov* to request that your mail be held.
- When possible, put passwords on your credit card, bank and phone accounts. Avoid using easily available information, such as your mother's maiden name, your birth date, the last four digits of your Social Security number or telephone number, or a series of consecutive numbers. Keep a list of your credit card issuers and their telephone numbers.
- Don't give out personal information on the telephone, through the mail or over the Internet unless you've initiated the contact or you know with whom you're dealing.
- Protect personal information in your home. For example, tear or shred documents such as charge receipts, copies of credit offers and applications, insurance forms, physicians' statements, discarded bank checks and statements, and expired credit cards before you throw them away. Be cautious about leaving personal information in plain view, especially if you have roommates, employ outside help or are having service work done.
- Find out who has access to your personal information at work and verify that the records are kept in a secure location.
- Never carry your Social Security card; leave it in a secure place at home. Give out your Social Security number only when absolutely necessary.
- Order your credit report from each of the three major credit reporting agencies every year to make sure it is accurate and includes only those activities you've authorized.

Wise Use of Credit

A buyer's responsibilities

As a wise consumer, you have a responsibility to:

- Decide ahead of time what items you can use credit to buy safely (and what items you need to pay for in cash).
- Set a total amount you can afford for credit card use at the beginning of the month and stick to it. It may need adjusting through time.
- Shop carefully to find the lender offering the best terms. Be sure to understand those terms.
- Know you are entitled to a written statement of all terms and conditions of any credit transaction you enter, and know in dollars exactly what you are paying for the credit.
- Protect your credit rating by reporting to creditors immediately if you are unable to make a payment due to unexpected circumstances. You may be able to extend the repayment period and lower the monthly payment.
- Shop as carefully when you use credit as when you use cash.
- Do not commit yourself to monthly credit payments that exceed the amount you are certain to be able to repay.
- Pay bills promptly to keep finance charges as low as possible.
- Keep copies of sales slips and promptly compare charges when your bills arrive.
- Protect your credit cards and account numbers to prevent unauthorized use. Draw a line through blank spaces above the total when you sign receipts. Rip up or retain carbon copies.
- Keep a list of your credit card numbers and the telephone numbers of each card issuer in a safe place and notify the card issuer immediately if your cards are lost or stolen.

A borrower's rights

As a wise consumer, you have these rights:

- To know the true interest rate and total finance charges before signing for any loan.
- To be given at least 14 days from the postmark on your credit card statement to pay off your balance and avoid interest. (But this does not apply to credit cards where the interest charges start at the date of purchase. Be sure to know the terms of your card.)
- To have charges canceled for shoddy goods costing more than $50 bought in your own state.
- To have a spouse's unblemished credit record count if you apply for credit on your own.
- To obtain credit on the basis of income from alimony, child support or a pension.
- To be told the specific reasons if you are turned down for a loan or credit card.
- To have a $50 ceiling placed on liability for unauthorized use of your credit card (this ceiling should drop to zero if you notify the card's issuer about its loss or theft before anyone tries to use it).

A Final Caveat –
Let the "Charger" Beware!

Consumer credit in its many forms is one of the most powerful economic forces in our society. When used wisely, it can be a tool that can help a family realize its goals. Future income is used to buy goods and services for immediate use at today's prices. Consumers can take advantage of sales, raise their standard of living and have ready access to funds and merchandise in case of a financial emergency.

Used carelessly, however, credit can be a mixed blessing. The ease of saying "charge it" can create compulsive buying habits that result in many more bills than your budget can handle.

On top of it all, the total cost for the goods or service has increased due to the finance charges.

The trick of wise credit management is to maintain control of your credit use.

When your credit obligations begin to control you, it is time to look seriously at how you are using credit.

For more information on this and other topics, see: www.ag.ndsu.edu

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