



Managing Money & Love

Issue 7: Using Credit Wisely

In the last issue, "Establishing Credit," you learned that using credit has advantages and disadvantages. This issue provides more facts and figures about credit to help you decide if using credit is for you. The information also focuses on the cost of credit and how to shop for credit to receive the most value for your money.

You can save...if you shop around! Starting a new job? Need to spruce up your wardrobe?

Let's say you spent \$1,000 on clothing using a credit card charging 18%* annual percentage rate (APR) interest and made the minimum payments to pay off the balance. It will take you more than five years to erase the debt, and your \$1,000 wardrobe would actually double in price by the time you pay an additional \$1,000 in interest. Using a credit card charging 12% APR interest, the wardrobe would cost you \$1,500 – a savings of more than \$500 in interest charges.

Moving to a new home? Need more furniture?

If you buy \$2,000 worth of furnishings with a credit card charging 18.5% APR interest and pay off the balance by making the minimum payments, it will take you more than 11 years to repay the debt. By the time the loan is paid off, you will have spent nearly \$1,934 extra on interest alone.

While you are shopping around for a new car, home, furnishings or clothes, don't forget to **compare credit costs**, including the following:

- ✓ total finance charges (dollar amounts)
- ✓ annual percentage rates (APR)
- ✓ late fees
- ✓ early pay-off penalty
- ✓ annual fees (\$0-\$75+ each year)
- ✓ security deposits (savings/collateral)
- ✓ cash advance fees and
- ✓ add-on insurance, protection or other services.

**Minimum payment based on 1/36 of the outstanding balance or \$20 – whichever is larger.*



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Credit Card Tips

- ✓ Beware of skip-a-month payment offers. Remember, you still pay interest on your outstanding debt, and your total interest costs continue to rise.
- ✓ While cash advances can look attractive, keep in mind that interest usually accrues from the moment you accept the cash. If you add in transaction fees, the annual interest on cash advances can be more expensive than you think.
- ✓ Be prepared for credit card theft. Keep a list of your credit card numbers in a secure place. The list should include the name and phone number of each card issuer. Report lost or stolen cards immediately. If you report the loss before a thief uses the card, you cannot be held liable for any purchases made with the card. If a thief uses a card before you report it missing, the most you will owe on each card is \$50.
- ✓ What is a grace period?
 - A. The “free period” when you don’t have to pay interest on your credit card debt.
 - B. The time between when you receive your credit card bill and when you have to pay it.

- C. The amount of time, usually 20 to 25 days, during which you don’t have to pay interest on purchases made with a credit card, if and only if you have no outstanding balance on your card.

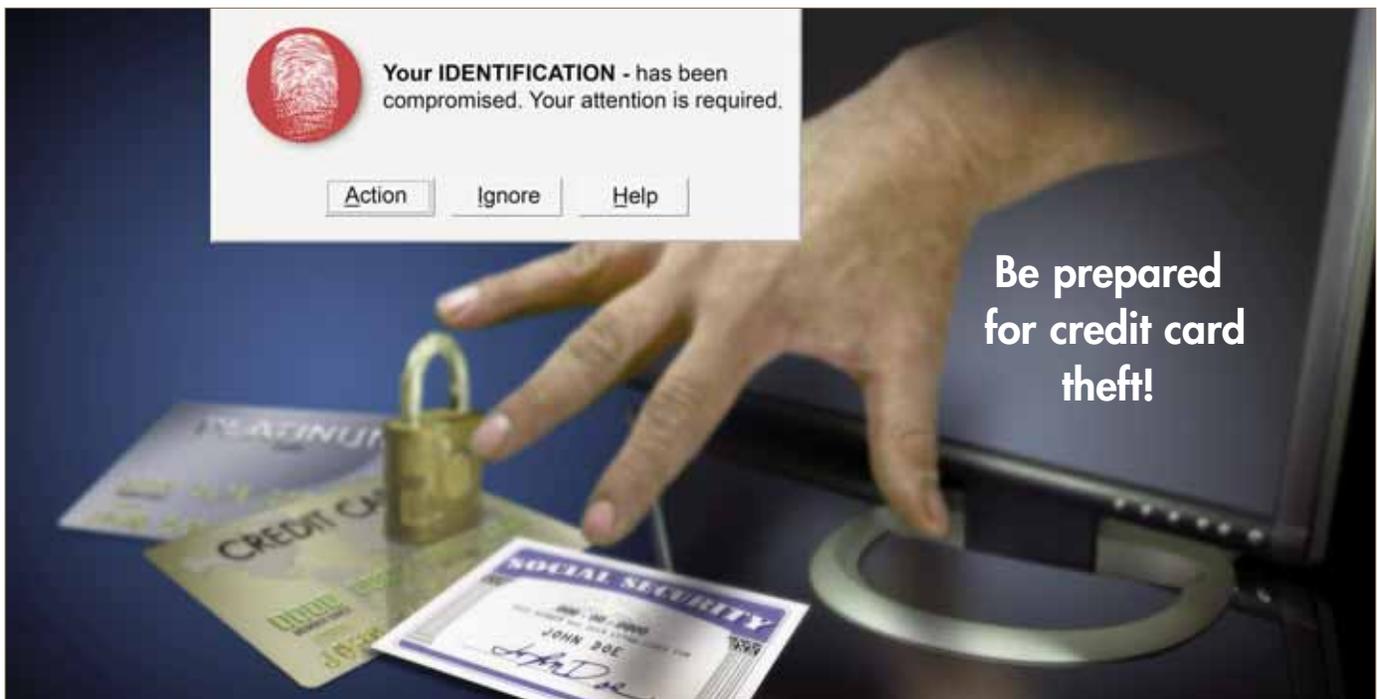
Correct Answer: For most cards, C. Credit cards usually offer consumers a grace period. But many consumers don’t realize that if you owe anything at all from a previous bill, you start paying interest from the moment you make a purchase.

If you were wrong, don’t be embarrassed. Eight out of ten consumers surveyed who knew they had a grace period didn’t know how it worked.

- ✓ When is the minimum the maximum?

If you pay the minimum monthly payment when you pay your credit card bill, you are paying the maximum interest. In fact, when interest is compounded, you could end up paying interest on your interest!

The minimum payment might be convenient if it’s all you can afford. But, whenever possible, pay as much as you can. If you have an 18.5% interest rate card, it will take you more than 11 years to pay off a debt of \$2,000 if you only pay the minimum balance due each month. During this time, you will pay interest charges of \$1,934, almost doubling the cost of your purchase. This calculation is based on making a payment that is 1/36th of the outstanding balance or \$20, whichever is greater.



Credit IQ Quick Quiz

- The percent of your take-home pay used for credit payments should not exceed:
a. 5% b. 10% c. 20% d. 25%
- A bank may refuse to offer you credit based on:
a. age
b. income and credit history
c. number of dependent children
d. marital status
- The best indicator of the cost of a loan is the:
a. number of monthly payments
b. monthly payment amount
c. interest rate
d. loan amount
- When shopping for credit cards, evaluate:
a. fees
b. the way interest is compounded
c. interest rates
d. all of the above
- A grace period is important because it:
a. allows you to skip one of your monthly payments
b. gives you a period of time during which to pay off your bill without incurring interest charges
c. allows you to charge over your approved line of credit for a month
d. requires you to pay off your balance over a set period of time
- The Equal Credit Opportunity Act states that:
a. consumers are protected from illegal discrimination based on race, color, religion, national origin, sex, marital status or age
b. a creditor cannot ask you to reapply, close your account or change terms of a loan if you become widowed or divorced
c. a creditor cannot turn you down for credit if your income comes from pensions, annuities or part-time income
d. all of the above
- To keep credit card interest payments as low as possible:
a. try to pay off your bills in full every month
b. take out a bank loan at a lower interest rate and use the money to pay off your credit card bills
c. switch to a different credit card that has a lower interest rate
d. all of the above
- If you carry a balance of \$2,000 with a card that charges 18% interest, by making the minimum monthly payment of 3%, you will pay off the loan in:
a. three years
b. six years
c. nine years
d. twelve years
- Which purchase would be a wise use of credit if money were tight?
a. eating out
b. going on a vacation
c. buying clothes on sale
d. buying a basic washer and dryer set
- A person with credit problems should:
a. commit themselves not to increase the debt they already have
b. analyze their spending habits and adjust them
c. contact a local consumer credit counseling service
d. all of the above

Answers
1. C 2. B 3. C 4. D 5. B
6. D 7. D 8. D 9. D 10. D

Scoring:

9-10 correct: Congratulations! You are credit-wise.

5-8 correct: Careful! You might be spending more money than is necessary. Learn your credit card's interest rate and fee schedule. Examine your cardholder agreement to find out the terms and conditions of your card. With a little knowledge, you can shop around and use a card that's right for you.

0-4 correct: Caution! You might want to call a local consumer group, credit counseling service or government office of consumer affairs for more information about the use of credit cards.

