Personal Financial Skills:

WORKBOOK 3:
Understanding Credit and Your Credit Report

The Home Depot
FannieMae FOUNDATION
Consumer Credit Counseling Service

Personal
Financial Skills

Realizing Your Financial Goals

Whether you want to buy a home, start a business or pay off your debt, personal financial skills are the first step to taking control of your financial future. The Personal Financial Skills workbook series will help you learn the necessary skills to maintain a family spending plan, use checking and savings accounts, build or repair your credit history, and apply for a loan. Regardless of your age, occupation or financial management experience, you will find useful skills and tips throughout this self-study material. Enjoy!

FannieMae FOUNDATION

The Fannie Mae Foundation creates affordable homeownership and housing opportunities through innovative partnerships and initiatives that build healthy, vibrant communities across the United States. The Foundation is specially committed to improving the quality of life for the people of its hometown, Washington, DC, and to enhancing the livability of the city's neighborhoods.

The Home Depot is the largest retailer in the home improvement industry. Our goal is to provide the highest level of customer service, the broadest selection of products and the most competitive prices. We are a values-driven company and our eight (8) core values include the following: Excellent customer service • Taking care of our people • Giving back • Doing the "right" thing • Creating shareholder value • Respect for all people /Entrepreneurial spirit • Building strong relationships.

Consumer Credit Counseling Service

Consumer Credit Counseling Service empowers people to enjoy a lifetime of economic freedom. CCCS educates all segments of society in the wise use of credit and provides an impartial forum for resolving debt problems. Named Agency of the Year for 1999 and 2000 by the National Foundation for Credit Counseling, CCCS Atlanta is the nation's premier debt-management service organization, characterized by excellence, integrity and technological innovation.

Table of Contents

Introduction

So, you want to take control of your financial future –

You've come to the right place. This self-study workbook series will help you to develop critical skills for financial independence. There are four workbooks:

Workbook 1: Developing a Spending Plan
Workbook 2: Working with Checking and Savings Accounts
Workbook 3: Understanding Credit and Your Credit Report
Workbook 4: Getting a Loan

Developing personal financial skills is the first step to taking control of your financial future. We have written these workbooks to help you learn financial skills that will give you the ability to plan your future. The following steps will help you use this workbook as a guide for your independent learning:

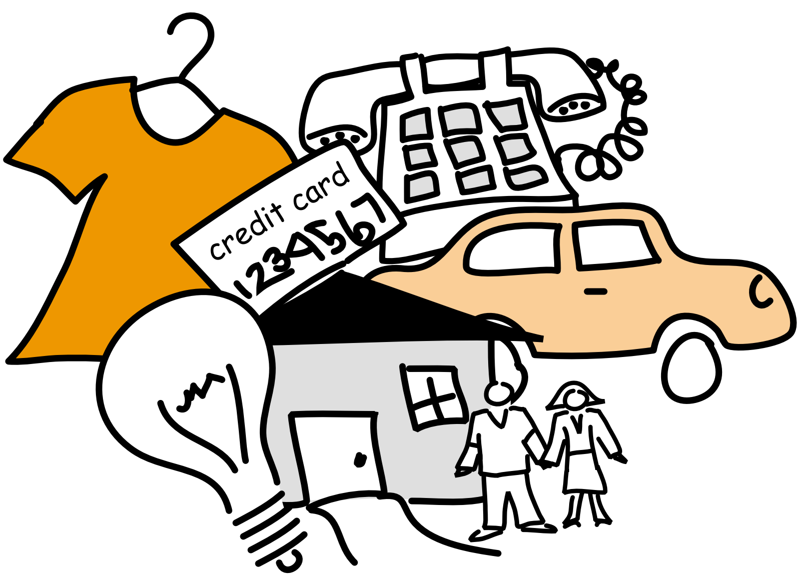
1. Begin each chapter by quickly scanning the headings. This will give you a basic idea of what you will be studying.
2. Each chapter has a number of subsections. Each subsection begins with study objectives stated as questions. To complete this workbook you will need to be able to answer these questions. As you read and find the answers, underline or highlight them for later reference. It is important to underline and write in this book to reinforce your learning.
3. All bold terms are defined in the workbook glossary. Refer to the glossary to assist you.
4. A short self-assessment follows each subsection. This will help check and reinforce what you have read. Answer each question and then check your answers at the bottom of the exercise.
5. At the end of each chapter you will find a Knowledge Review. Use this opportunity to review the concepts discussed in this workbook.
6. You will need a pencil and a calculator to complete this workbook.

Workbook 3

Understanding Credit and Your Credit Report

Workbook Objectives

In this workbook we will discuss:
- the purpose of credit
- the importance of your credit history
- how to read and analyze your credit report
- steps you can take to correct errors on your credit report
- steps you can take to build, maintain, and rebuild your credit history



Credit is when you borrow money and plan to repay it. Any time a bank, family member, or business lends you money and you agree to pay it back at a later date, you are using credit. In most cases, there is a charge for borrowing the money. The charge is in the form of either fees or interest. Credit is used to start businesses, buy cars, build houses, buy houses, and make daily purchases. It allows you to make a purchase without having to pay the entire price at once.

Study Objectives

Underline/highlight the answers to these questions as you read:
1. **What is credit?**
2. **What are the advantages and disadvantages of using credit?**

Your Credit Experience Exercise

Do you make purchases using credit? Answer the following questions to start thinking about your experience with credit.

1. What kinds of purchases do you make with credit?
   ____
   ____
2. How do you decide whether to use credit or cash for a purchase?
   ____
   ____
3. Do you know what a credit report is? ____________________
4. Are you sure that the information on your credit report is correct?____________
5. Do you know how to correct errors on your credit report?________________

Advantages and Disadvantages of Credit

There are both advantages and disadvantages to using credit.

Disadvantages include:

- **Credit costs money.** There is usually a charge for spreading payments over a period of time.
- **Credit can tempt you to spend more money than you can afford to repay.** You are more likely to purchase items that you do not need.
- **When you make a purchase using credit, you commit to using your future income to repay the loan.** It means that you will have less money in the future to spend on other things.
- **Lenders will report all missed credit payments to the credit bureaus. This will affect your ability to get additional credit in the future.**
- **If you mismanage credit and are unable to repay the lender, they may repossess, or take back, the item you purchase.**
- **Lenders, employers, and landlords often request a copy of your credit report. If you mismanage your credit, it can affect your ability to get additional credit, get a job, rent an apartment, or buy a house in the future.**

Can you think of any other disadvantages to using credit?

Advantages include:

- **Credit allows you to purchase large items that you might not have enough cash to pay for such as a car, house, or college education.** Sometimes household items will go on sale or be needed at a time when you do not have cash available. Credit can be used to make these purchases, so you can use the item while you take some time to pay for it.

- **Credit is a good tool in an emergency situation.** Faced with an expensive medical situation, credit enables you to spread the cost over a period of time.

- **Credit is convenient.** Using a credit card is a way to pay for things without having to carry large amounts of cash. Also, your monthly credit card statement provides you with a record of your purchases.

Can you think of any other advantages to using credit?

Self-Assessment 1

1. Credit is:
   - ❏ a. a kind of card.
   - ❏ b. when you borrow money and plan to repay it.

2. The disadvantages of using credit include (check all that apply):
   - ❏ a. it costs money.
   - ❏ b. it is tempting to spend more than you can afford to repay.
   - ❏ c. mismanagement can result in repossession and affect your ability to get credit in the future.

How did you do?: 1.b 2.a,b,c

Study Objectives

Underline/highlight the answers to these questions as you read:

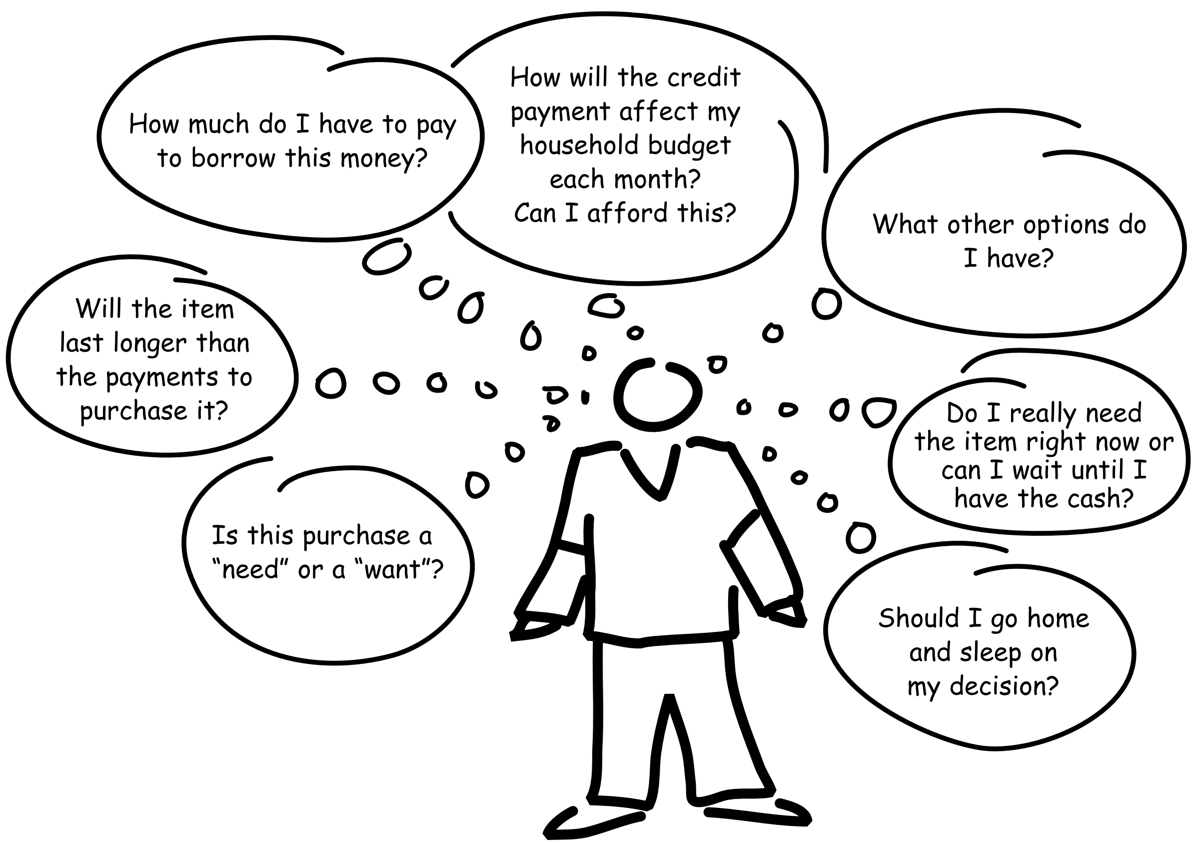
1. **What kinds of questions should you ask yourself before using credit for a purchase?**
2. **What are the different types of credit?**

Using Credit

Spending money today means that it will take longer to accomplish your savings goals (refer to *Workbook 1: Developing a Spending Plan*). Try to strike a balance between meeting your "needs" and saving money. To do this, learn to recognize the difference between your "needs" and your "wants."

Before you make a purchase, ask yourself if the item is a "need" or a "want." Needs are items that are essential based on your lifestyle and values. Housing and education might qualify as needs. Wants are items that you desire, but that are not necessary, such as a snack or expensive clothes. Because credit generally costs money, it is best to use it for "need" type purchases. Satisfy your "wants" with cash that you save over time.

Try asking yourself the following questions before you use credit for a purchase:



Using Credit Exercise

Review the following situations. Use the questions from the previous page to decide if credit is a good way to make the purchase. Mark your answer. List your reason in the space provided. There are no right or wrong answers.

Item/Situation	Yes	No	Maybe	Reason
A friend's birthday present				
Weekly groceries				
College education				
New shoes when your shoes are still in good condition				
New refrigerator because yours broke				
A snack				
A house				
Medical procedure that the doctor tells you to have done immediately				
Overdue bills				
Car repairs				
Vacation				
A car purchase when yours runs fine				

See page 25 for suggested answers.

Types of Credit

When used wisely, credit can be an effective tool to make purchases. There are a number of different types of credit. The most common types of credit are:

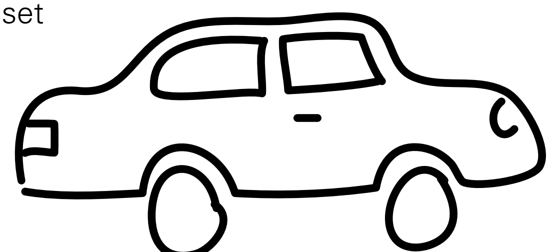
Revolving credit

This type of credit allows you to borrow money at any time up to a set limit. As you pay the borrowed money back, it becomes available again to borrow. The lender allows you to pay back the money in a lump sum or over an extended period of time. If you pay back the debt over time, you are charged a fee each month on the amount that you owe. This fee is called **interest**.

The most common types of **revolving credit** are credit cards, such as VISA or MasterCard, department store cards, and gasoline cards. Make sure you understand the type of credit card you have and how interest is charged.

Installment credit

This type of credit allows you to borrow a specific amount of money at one time for a defined purpose. You establish a payment plan with your lender to repay the loan on a regular basis over a period of time. The amount of interest that you will pay is determined in advance and calculated into your set monthly payments.



This type of credit is common for larger purchases such as a car, a home, or education.

Noninstallment or service credit

Some businesses and utility companies offer this type of credit. It allows you to pay for a used service at a later date. Often, if you pay the complete sum within a specified period of time, usually 30 to 60 days, you do not have to pay fees or interest. If you are unable to make the payment within the specified time, there is usually a penalty charge that will be added to your debt.

Secured and Unsecured Credit

Most types of credit can be obtained in one of two forms—**secured** or **unsecured** credit.

Secured credit

This type of credit requires you to provide something of value to guarantee that you will repay your debt. It is usually used for installment loans. If you fail to repay, the lender takes your item as repayment. Personal valuables such as cash or a car are used to secure loans.

Unsecured credit

This type of credit does not require a guarantee.

Self-Assessment 2

1. True or False. Use credit to purchase things you want because you should never have to wait to get something.
   - ❑ a. True
   - ❑ b. False

2. True or False. Always consider how a credit payment will affect your monthly budget before using credit for a purchase.
   - ❑ a. True
   - ❑ b. False

3. When you use installment credit (check all that apply):
   - ❑ a. you are borrowing a set amount of money for a specific period of time.
   - ❑ b. the amount of interest you are going to pay for the loan is determined in advance and calculated into your monthly payments.

4. When you use secured credit:
   - ❑ a. you provide the lender with something of value to guarantee that you will repay the debt.
   - ❑ b. you are not required to provide the lender with any guarantee of repayment.

How did you do?: 1.b 2.a 3.a,b 4.a

Study Objectives

Underline/highlight the answers to these questions as you read:

1. **What is a credit bureau?**
2. **What is a credit report?**
3. **How often should you review a copy of your credit report?**

Your Credit Report

Sometimes people think that they have a good history of handling credit. Then they apply for a loan and are surprised to learn that there are some problems with their credit. The best way to find out if you have good credit is to get a copy of your **credit report.**

A credit report is a record of how you have paid your credit card debt and other loans. A credit report shows how much debt you have, if you have made payments on time, or if you have not paid back some loans at all. Credit reports do not show information about your race, religion, medical history, personal lifestyle, political preferences, criminal record, or any other information unrelated to credit.

Credit reports are compiled by national credit reporting agencies called **credit bureaus**. They get their information from a variety of sources such as banks, department stores, medical providers, and credit card companies.

Credit reports are used for many purposes. They are an important part of your loan application. Landlords and employers use them to evaluate your reliability and your ability to manage your finances. Therefore, it is very important that you maintain a good **credit history** and that it is accurately reflected on your credit report.

The typical credit report includes four types of information:

Identifying information: your name, current and previous addresses, telephone number, Social Security number, date of birth, and current and previous employers. This information comes from your credit applications.

Credit information: specific details about your credit cards, student loans, and other loans. This information includes the date opened, credit limit or loan amount, balance, and monthly payment. The report also shows your payment history during the past several years and the names of anyone else responsible for paying the account, such as a spouse or a co-signer. Late payments, skipped payments, accounts turned over to a collection agency, and repossessions appear here.

Public record information: bankruptcy records, foreclosures, tax liens for unpaid taxes, monetary court judgments (such as lawsuits), and in some states, overdue child support. This information comes from public records.

Inquiries: the names of those who obtained a copy of your credit report and how often you have applied for credit in the past two years. There are two types of inquiries: promotional inquiries or "uninvited inquiries" and credit inquiries. Promotional inquiries are when companies request a copy of your credit report to "pre-approve" you for a credit card or special offer. They are listed separately from credit inquiries that you request. Potential creditors should only see the credit inquiries you initiate (by applying for a new credit card, for example).

Reading Your Credit Report

While your credit report may not look exactly like this, it will contain the same information. Use this credit report to answer the questions on the next page.

The name and address of the office you should contact if you have any questions or disagreement with this credit report

```
Please address all future          CREDIT REPORTING OFFICE
correspondence to the address      BUSINESS ADDRESS
shown on the right.                CITY STATE 00000
                                   PHONE NUMBER
```

I.D. section

Your name, current address, and other identifying information reported by your creditors

```
KEN NGUYEN             DATE 12/04/00
123 HOME ADDRESS       SOCIAL SECURITY NUMBER 123-45-6789
CITY, STATE 00000      DATE OF BIRTH 04/19/67
                       SPOUSE LHANA
```

Credit history section

List of both open and closed accounts

The first item identifies the business that is reporting the information.

This is your account number with the company reporting.

Number of months account payment history has been reported.

This is the month and year you opened the account with the credit grantor.

See explanation below.

This is the date of last activity on the account and may be the date of last payment or the date of last change.

The highest amount charged or the credit limit.

Represents number of installment or monthly payments

The amount owed on the account at the time it was reported.

This figure indicates any amount past due at the time the information was reported.

See explanation below.

Date of last account update.

Company Name	Account Number	Whose Acct.	Date Opened	Months Reviewed	Date of Last Activity	High Credit	Terms	Items as of Date Reported: Balance	Past Due	Status	Date Reported
EXAMPLE BANK	11251514	J	05/96	66	10/98	3500		0		R1	12/99
WORLDBANK	2953900000100473	I	11/96	48	11/98	9388		0		I1	11/99
CREDIT WORLD	355411251511	A	06/97	24	05/00	500		0		01	12/99
SAVE CITY	54229778	I	05/98	48	02/00	5000	340	3000	680	R3	12/99

```
>>> PRIOR PAYING HISTORY - 30(03)  60(04)  90+(01)  12/99-R2,  12/00-R3,  06/96-R4 <<<
```

Number of times account was either 30/60/90 days past due.

Date two most recent delinquencies occurred plus date of most severe delinquency.

Collection accounts

Accounts that your creditors turned over to a collection agency

```
>>> COLLECTION REPORTED 06/98; ASSIGNED 09/97 TO PRO COLL (800) 555-1234
    CLIENT- ABC HOSPITAL; AMOUNT-$600; STAT UNPAID 06/98; BALANCE-$600 06/98
    DATE OF LAST ACTIVITY 09/97; INDIVIDUAL; ACCOUNT NUMBER 787652JC

>>>>>>>>>>>>>>>>>>>>>  COLLECTION AGENCY TELEPHONE NUMBER (S)  <<<<<<<<<<<<<<<<<<<<<<
   PRO COLL (800) 555-1234
```

Courthouse records

Public record items obtained from local, state, and federal courts

```
****************************COURTHOUSE RECORDS*******************************

>>> LIEN FILED 03/98; FULTON CTY; CASE NUMBER-32114; AMOUNT-$26667; CLASS-CITY/COUNTY;
    RELEASED 07/98; VERIFIED 09/98

>>> BANKRUPTCY FILED 12/97; NORTHERN DIST CT; CASE NUMBER-079HCO12, LIABILITIES-$15787;
    PERSONAL; INDIVIDUAL; DISCHARGED; ASSETS-$780

>>> JUDGMENT FILED 07/97; FULTON CTY; CASE NUMBER-898872; DEFENDANT- KEN NGUYEN
    AMOUNT-$8984; PLAINTIFF-ABC REAL ESTATE; SATISFIED 03/99; VERIFIED 05/99
```

Additional information

Primarily consists of your former addresses and employments reported by your creditors

```
*************************ADDITIONAL INFORMATION****************************

FORMER ADDRESS 456 LAKE RD, SAN FRANCISCO, CA 94311

FORMER ADDRESS P.O. BOX 2138, LOS ANGELES, CA 90250

CURRENT EMPLOYMENT CASHIER, HOME DEPOT
```

Inquiry section

List of businesses that have received your credit report in the last 24 months

```
**************COMPANIES THAT REQUESTED YOUR CREDIT HISTORY*****************

05/00 EQUIFAX                        11/99  AUTOWORLD
3/00 PRM CREDIT                      10/99  WORLDBANK
01/00 EXAMPLE BANK                   08/99  BUSINESS WORLD
01/00 SAVE CITY                      06/99  EXAMPLE BANK
```

WHOSE ACCOUNT

Indicates who is responsible for the account and the type of participation you have with the account.

J = Joint
I = Individual
U = Undesignated
A = Authorized user
T = Terminated
M = Maker
C = Co-Maker/Co-Signer
B = On behalf of another person
S = Shared

THE FOLLOWING INQUIRIES ARE NOT REPORTED TO BUSINESSES:

PRM—This type of inquiry means that only your name and address were given to a credit grantor so they could offer you an application for credit. (PRM inquiries remain for six months.)

AM or AR—These inquiries indicate a periodic review of your credit history by one of your creditors. (AM and AR inquiries remain for six months.)

EQUIFAX, ACIS, or UPDATE—These inquiries indicate Equifax's activity in response to your contact with them for either a copy of your credit report of a request for research.

PRM, AM, AR, EQUIFAX, ACIS, and UPDATE inquiries do not show on credit reports that businesses receive, only on copies provided to you.

STATUS

Type of Account

O= Open (entire balance due each month)

R = Revolving (payment amount variable)

I = Installment (fixed number of payments)

Timeliness of Payment

0 = Approved not used
1 = Paid as agreed
2 = 30 days past due
3 = 60 days past due
4 = 90 days past due
5 = 120 days past due or collection account
7 = Making regular payments under wage-earner plan or similar arrangement
8 = Repossession
9 = Seriously delinquent/bad debt (paid or unpaid); charged-off account.

Credit Report Exercise

Use the credit report on page 11 to answer the following questions.

1. Whose credit report is this?

2. What is the date of this report?

3. Do any of the accounts listed in the credit history section indicate bills that were not paid on time?

4. Have any accounts been turned over to a collection agency? What company did he owe money to?

5. Does he have any public record items that might be of interest to a potential lender?

6. When was the last credit inquiry?

7. Would you make a loan to him? Why? Why not?

See page 26 for suggested answers.

Reviewing Your Credit Report

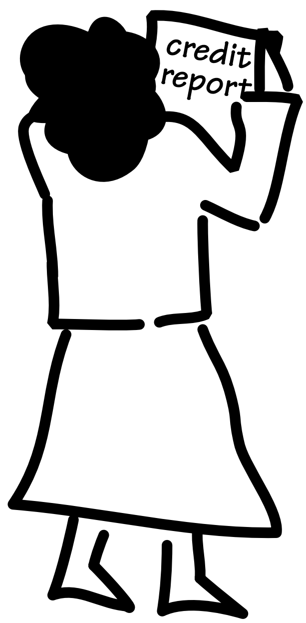
Because mistakes do happen, you should review a copy of your credit report each year. There are three major credit bureaus. You should order a copy of your credit report from each of the bureaus. In some states, credit reports are free and in others there is a small fee for sending you the report. Credit bureaus are required by law to provide a report to you, and to include any corrections you have. If you have been denied credit, you are entitled to a free copy of your credit report. However, you must ask the agency that produced the credit report for a copy of it within a specified period of time, usually 60 days. The credit bureau will usually charge you a small fee for sending you the report.

You can contact each credit bureau by either writing a letter, making a telephone call, or sending an e-mail. Use the following contact information to assist you:

Equifax
P.O. Box 105873
Atlanta, GA 30348
1-800-685-1111
www.equifax.com

Trans Union Corporation
P.O. Box 390
Springfield, PA 19064-0390
1-800-916-8800
www.transunion.com

Experian
P.O. Box 2350
Chatsworth, CA 91313-2350
1-888-EXPERIAN (397-3742)
www.experian.com



Self-Assessment 3

1. A credit bureau is (check all that apply):
   - ❑ a. an organization that keeps a record of how you have handled credit in the past.
   - ❑ b. a set of drawers where you can keep your credit cards.
   - ❑ c. an organization that will send a lender a copy of your credit report.

2. Your credit report indicates:
   - ❑ a. your grade for handling credit.
   - ❑ b. your record of paying bills on time.

3. True or False. You should review a copy of your credit report each year.
   - ❑ a. True
   - ❑ b. False

How did you do?: 1.a,c 2.b 3.a

Correcting Errors on Your Credit Report

Sometimes there are errors on credit reports. When you receive your credit report, read it carefully and be sure that it is correct. Directions for correcting mistakes will come with the copy of your credit report. Use the sample letters on the following pages to help you contact your credit bureau.

If you identify an error on your credit report, you will want to take the following steps:

- Copy your credit report.
- Highlight the error.
- Write a letter of dispute that includes an explanation of the error (example on page 16).
- Locate and copy any additional information that can help establish that the item is an error (e.g., a canceled check used for payment).
- Send the highlighted copy of your credit report, statement of explanation (example on page 17), and a copy of any additional information to the credit bureau.

Study Objectives

Underline/highlight the answers to these questions as you read:

1. **What do you do if there is an error on your credit report?**
2. **What are some common errors that occur on credit reports?**

When the credit bureau receives your letter, it will contact the creditor to investigate your claim. If you are correct, the credit bureau will remove the incorrect item from your credit report. If the creditor does not believe that it is a mistake, you will need to address the issue with the creditor. Until the issue is resolved, you will want to have the credit bureau include a statement of explanation on your credit report. A sample letter asking the credit bureau to include a statement of explanation on your credit report is on page 17.

The following are common errors that occur on credit reports:

Duplicate information

Sometimes accounts will appear more than once on your credit report. If this happens, take the steps listed above to correct the error.

Uninvited inquiries

Everyone who has looked at your credit report over the past two years is listed in the inquiry section of your credit report. Promotional inquiries should be listed separately from the inquiries that were made for the purpose of acquiring additional credit. A lender will look at the number of inquiries that were made for the purpose of acquiring additional credit. Too many inquiries for this purpose can work against you when you apply for a loan. If someone has looked at your report without your permission, take the steps listed above to correct the error.

Items that should no longer be listed

Items stay on your credit report for a specific amount of time.

- Promotional inquiries stay on your credit report for six months.
- Inquiries stay on your credit report for two years.
- Delinquencies, garnishments, repossessions, court orders, evictions, and unpaid child support stay on your credit report for seven years.
- Bankruptcy stays on your credit report for seven to 10 years.

If an item stays on your credit report longer than it should, take the steps listed above to correct the error.

Example Letter of Dispute

If you find an error on your credit report, contact the creditor and try to resolve the problem. In addition, you will want to complete and send a letter of dispute to the credit bureau. You can use the dispute form that is included with the copy of your credit report or write a letter as follows:

example

[Date]

TO: *[Name of credit reporting agency]*

ATTN: Consumer Relations

RE: *[Your name]*
[Address]
[Telephone]
[Social Security number]
[Date of birth]

I recently obtained a copy of my credit report and found (an) item(s) to be in error. Please begin an immediate investigation of the item(s) listed below and highlighted on the attached copy of my credit report.

Identified errors [List errors and provide an explanation.]

1. *[Merchant name]* *[Account number]* *[Date reported]*

   [Insert your own explanation of the error. The following is an example:

   A collection is reported on my Example Company account (account number 12-345-6789) 7/00. Please see the attached copy of my returned check indicating the payment of this bill in 1/00. I have sent a similar letter and copy of this check to Example Company so that they will correct their records. Please remove any unverifiable or inaccurate information from my credit file. Please send me a new copy of my credit report at the conclusion of your investigation.]

Thank you for your help and prompt attention to this matter.

Respectfully,

[Your signature]
[Your name typed]

Example Statement of Explanation

If you would like the credit bureau to include an explanation of an item on your credit report, you can complete and send the following letter:

[Date]

example

TO: *[Name of credit reporting agency]*

ATTN: Consumer Relations

RE: *[Your name]*
[Address]
[Telephone]
[Social Security number]
[Date of birth]

In accordance with the Fair Credit Reporting Act, please include the following statement in my credit report. It should be positioned with the disputed account.

Disputed account
[Merchant name] *[Account number]* *[Date reported]*

Statement of explanation

[Insert your own explanation of no more than 100 words. The following is an example:

On January 1, 2000, I was involved in an automobile accident. I was sent to the hospital. The medical bills were sent to my insurance company. Because the other party was responsible for paying the bills, my insurance company did not pay the hospital. The hospital sent my account to collections. About 90 days later, my insurance company paid the hospital bills. Unfortunately, the hospital's collection agency refused to reflect the circumstances that resulted in a late payment on my record.]

Please send me a copy of my updated credit report after the above statement has been added.

Thank you for your prompt attention to this matter.

Respectfully,

[Your signature]
[Your name typed]

Self-Assessment 4

1. If you identify an error on your credit report, you should (check all that apply):
   - ❑ a. identify the error and contact the credit bureau to correct it.
   - ❑ b. get angry and rip up the report.
   - ❑ c. collect information that proves that the credit report contains an error.

2. Common errors on credit reports include (check all that apply):
   - ❑ a. information that is repeated more than once.
   - ❑ b. your name spelled backwards.
   - ❑ c. items that should no longer be listed.

How did you do?: 1.a,c 2.a,c

Tips to Create, Maintain, or Reestablish Your Credit History

Whether you are trying to establish, maintain, or reestablish your credit record, there are a number of steps you can take to accomplish your goal. The following are some suggestions. Can you think of others?

Study Objectives

Underline/highlight the answers to this question as you read:

1. What can you do to create, maintain, or reestablish your credit history?

Tip #1 Pay your bills on time.

This is one of the best steps to achieve a good credit record. Even if you have no credit history at this time, you can establish a positive record through timely payment of your bills (e.g., rent, utilities).

What action can you take to remind yourself to pay your bills on time?

____

____

Tip #2 Contact lenders immediately if you expect to have a payment problem.

Sometimes there are unusual or unforeseen circumstances that make it very difficult or impossible to pay your bills on time. If you find yourself in this situation, it is important that you immediately contact the organization to which you owe money. Often you can set up an adjusted payment schedule that will work for you. Working with the organization can help you avoid additional fees and having your overdue bills turned over to a collection agency.

What risks do you take by contacting your lender if you think there may be a payment problem? What are the benefits?

____

____

Tip #3 Borrow no more than you can comfortably pay back.

When you are ready to borrow money, review your monthly budget with your lender or someone who understands financial management. Discuss how large a loan payment you can afford each month. Do not let anyone talk you into borrowing more money than you are comfortable with.

What action can you take to make sure you borrow only what you can comfortably pay back?

____

____

Tip #4 Don't bounce checks.

Do not write checks that exceed the funds available in your checking account. The cost for bouncing a check can range from $15 to $50, and it is a waste of money. A bounced check can make your bill payment late so that it is reported to the credit bureau.

What action can you take to make sure that you do not bounce checks?

Tip #5 Read and understand loan terms and agreements before you sign anything.

It is important that you understand your loan terms and agreements to avoid committing to payments that you cannot afford. If you are unable to repay a loan, it negatively affects your credit report and your future access to credit.

What action can you take to make sure that you understand your loan terms and agreements?

Tip #6 Be cautious about co-signing or guaranteeing loans for others.

Always consider a person's intention, commitment, and ability to repay a debt before you agree to co-sign or guarantee a loan. When you co-sign or guarantee a loan for someone, you are agreeing to take responsibility for repaying that person's debt if he or she is unable to do it. Additional debt can significantly affect your budget. If you are unable to make the payment, the debt negatively affects your credit report.

What actions should you take before you co-sign or guarantee loans for others?

Tip #7 Apply for a secured credit card.

A **secured credit card** is when you deposit a certain amount of cash in a savings account and use it to guarantee your credit card. After you consistently repay your balance each month, your credit limit will be increased. Secured credit cards are a great way to build a credit history and demonstrate that you can responsibly handle a credit card.

What action can you take to apply for a secured credit card?

Tip #8 Avoid excessive inquiries into your credit report.

Too many inquiries into your credit report can work against you when you apply for a loan. Be aware of situations, such as shopping for a car, where a business may check your credit without your knowledge. In such situations, ask how many inquiries will result from their check. Be particular about whom you give permission to check your credit report.

Tip #9 Review your credit report at least once a year and correct any inaccurate information it may contain.

Sometimes there are errors on credit reports. Make sure that your credit report accurately reflects your credit history. If you know that you are going to apply for a loan, review your credit report at least three months ahead of time. Remember to check all three credit bureaus because their reports may differ.

Tip #10 Create a nontraditional credit history.

If you do not have an established credit history, you can create a **nontraditional credit history** for yourself. You will be able to use it to apply for credit in the future. To build a nontraditional credit history:

- Keep copies of your paid bills.
- Keep copies of the canceled checks used to pay your bills.
- Ask those people/organizations to whom you pay bills to write a letter stating how long you have been a customer and paid your bills on time.
- Consider getting a secured credit card. When you use the card, be sure to make payments on time each month.

Show the information you have collected to lenders when you apply for credit.

Tip #11 Think long term.

Establishing or reestablishing your credit takes time. It may take a couple of years of paying bills on time to establish a strong enough credit history to qualify for a car loan. It may take even longer to qualify for a mortgage. If you are reestablishing your credit, it may take several years of consistent bill payment before a lender will give you another chance. Stick with it. A good credit history is worth working for.

What action can you take to remind yourself that establishing, reestablishing, or maintaining credit is a long-term process?

Tip #12 Call Consumer Credit Counseling Service (CCCS) at 1-866-499-8771 for assistance.

An expert at CCCS will be able to spend time working through your personal financial issues. All discussions with CCCS are confidential and free of charge.

Are there any other tips you can think of?

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See page 27 for suggested actions.

Self-Assessment 5

Given your credit habits, which of these tips is the most important for you to remember?

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Summary Points

- Credit is when you borrow funds with the intent to repay them. In most cases, there is a charge for borrowing the money.
- Identify "needs" versus "wants." Avoid using credit to purchase things that you want.
- Revolving credit allows you to borrow money at any time up to a set limit. As you pay the borrowed money back, it becomes available again to borrow.
- Installment credit allows you to borrow a specific amount of money at one time for a defined purpose.
- Noninstallment or service credit allows you to pay for a used service at a later date.
- Secured credit is when you provide something of value to guarantee that you will repay a debt.
- Unsecured credit is when you do not provide anything to guarantee repayment of a loan.
- A credit report is a record of your bill payment history.
- Review a copy of your credit report each year to make sure that it accurately reflects your credit history. Request reports from all three credit bureaus because information may differ. Address any mistakes on your credit report immediately.
- Your credit history can affect the opportunities available to you (e.g., getting approved for a loan or hired at a new job). Take the time to establish, maintain, or repair your credit history.
- If you do not have a credit history, take the time to collect the information for a nontraditional credit history:
    - Keep copies of your paid bills.
    - Keep copies of canceled checks used to pay your bills.
    - Ask those people/organizations to whom you pay bills to write a letter stating how long you have been a customer and paid your bills on time.
    - Consider getting a secured credit card. When you use the card, be sure to make payments on time each month.
- If you have any questions about credit or your credit report, call Consumer Credit Counseling Service (CCCS) toll-free at 1-866-499-8771 for assistance.

To review the concepts covered in this session, complete the Journal or the Self-Assessment exercise.

Journal

Take a few moments to write down the most important or useful ideas you learned in this workbook. What concepts do you want to remember?

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Self-Assessment

Answer the following questions. Use the information in this workbook to help you.

1. Why should you use credit to purchase items that you "need" instead of things that you "want"?

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2. How are installment and revolving credit different?

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3. What is the difference between secured and unsecured credit?

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4. Why is your credit report important?

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5. Is it possible for your credit report to contain errors? ____________

6. If you are not able to pay a bill on time, what is the first thing you should do?

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See page 28 for suggested answers.

Using Credit Exercise

The following are some suggested answers. Remember your decision to use credit for a purchase should be based on your personal financial situation.

Item/Situation	Yes	No	Maybe	Reason
A friend's birthday present		X		It is best to buy a present that fits within your budget because it is not a necessary item.
Weekly groceries		X		The cost of groceries should be a part of your monthly budget.
College education	X			A college education is a significant expense that is most often spread over a period of time to make repayment more manageable.
New shoes when your shoes are still in good condition		X		Shoes are not a needed item when you already have a good pair. They should be purchased only when you have saved enough money in your savings account.
New refrigerator because yours broke			X	Depending on the size of the bill, you may be able to pay cash or use your savings for this expense. You might consider looking at used appliances before you commit to purchasing a new refrigerator with credit.
A snack		X		Snacks are not needs. They should be purchased only with savings or if you have extra cash after paying your monthly expenses.
A house	X			A house is a significant purchase. The expense is often spread over a period of time to make repayment more manageable.
Medical procedure that the doctor tells you to have done immediately			X	Depending on the size of the bill, you may be able to pay cash or use your savings for this expense. Otherwise, repayment of this bill will need to become part of your monthly budget for a period of time.
Overdue bills		X		It is best to avoid paying debt by acquiring new debt. There will be additional new expenses, in the form of interest and/or fees, to pay for this new debt.
Car repairs			X	It depends. If you need your car to get to work each day, you may need to use credit and fix it right away. If you have multiple cars or other ways of getting around, you may want to put money aside each week until you can afford the cost.
Vacation		X		Savings should be used to pay for trips. Choose a destination that fits within your budget.
A car purchase when yours runs fine			X	Consider buying a used car and putting your savings toward the purchase.

Credit Report Exercise Answers

1. Whose credit report is this?

   Ken Nguyen

2. What is the date of this report?

   12/4/00

3. Do any of the accounts listed in the credit history section indicate bills that were not paid on time?

   Yes. Ken's Save City credit line was 60 days past due, as indicated by the R3 status under "Items as of Date Reported."

4. Have any accounts been turned over to a collection agency? What company did he owe money to?

   Yes. In 9/97 his account's outstanding bill from ABC hospital for $600 was turned over to a collection agency. This information was reported to the credit bureau in 6/98.

5. Does he have any public record items that might be of interest to a potential lender?

   He has filed bankruptcy as well as having a lien and judgment filed against him.

6. When was the last credit inquiry?

   The last credit inquiry was 5/00 by Equifax.

7. Would you make a loan to him? Why? Why not?

   No. It is unlikely that a financial institution would make a loan to Ken because he has not demonstrated that he can responsibly pay his bills on time.

Tips to Create, Maintain, or Reestablish Your Credit History and Suggested Actions

Tip #1 **Pay your bills on time.**
- Set a time each week, such as Sunday night, to pay your bills.
- Mark on your calendar the day that a bill is a due.

Tip #2 **Contact lenders immediately if you expect to have a payment problem.**
- While many people perceive that there is a risk in telling a lender that you are having a payment problem, lenders actually appreciate having you communicate with them. When you contact a lender, you can work out a payment plan that meets both of your needs.

Tip #3 **Borrow no more than what you can comfortable pay back.**
- Before you sign a loan agreement, rework your spending plan with the new loan monthly payment. Make sure that you are comfortable with how the new loan affects your overall spending plan.

Tip #4 **Do not bounce checks.**
- Keep current detailed records of how much is available in your checking account. This record should include all transactions that are withdrawn from your checking account (checks, ATM withdrawals and fees, and debit card transactions). Always check your balance before you write a check.

Tip #5 **Read and understand loan terms and agreements before you sign anything.**
- Ask your lender to explain what all terms and agreements mean. Do not be embarrassed to ask lots of questions.
- Bring a friend or relative who understands financial issues with you to the lender.

Tip #6 **Be cautious about co-signing or guaranteeing loans for others.**
- Help your family member or friend work through their credit issues by suggesting community resources such as Consumer Credit Counseling Service.

Tip #7 **Apply for a secured credit card.**
- Visit your local financial institution and collect information about a secured card. Determine if there are any costs associated with the card and if it meets your needs.

Tip #8 **Avoid excessive inquiries into your credit report.**
- Choose whom you give permission to run a credit check. Be aware of situations, such as car dealerships, where they may ask a number of financial institutions to consider giving you a loan. In such situations, ask how many inquiries will result from their check.

Tip #9 **Review your credit report at least once each year and correct any inaccurate information it may contain.**
- Request a copy of your credit report from each credit bureau.

Tip #10 **Create a nontraditional credit history.**
- Keep copies of your paid bills.
- Keep copies of the canceled checks used to pay your bills.
- Ask those people/organizations to whom you pay bills to write a letter stating how long you have been a customer and paid your bills on time.
- Consider getting a secured card. When you use the card make sure to make payments on time each month.

Tip #11 **Think long term.**
- Cut out a picture of a long-term goal, such as a house or a car. Use the picture as motivation to put the time and energy into working through your credit issues.

Tip #12 **Call Consumer Credit Counseling Service (CCCS) at 1-866-499-8771 for assistance.**

Knowledge Review Answers

Self-Assessment

1. Why should you use credit to purchase items that you "need" instead of things that you "want"?

   Credit costs money. It only makes sense to pay the extra money (e.g., interest, fees) on items that you truly need to purchase.

2. How are installment and revolving credit different?

   You use installment credit to borrow a specific amount of money at one time for a defined purchase. For instance, when you purchase a house, you need to pay the seller a specific amount of money. You can take out an installment loan and pay the lender back in regular monthly payments over a set period of time.

   On the other hand, revolving credit allows you to borrow money at any time up to a set limit. As you repay the borrowed money, it becomes available again to borrow.

   Often, installment loans are used for large purchases such a car, house, or education, because revolving credit limits do not provide enough money for such items.

3. What is the difference between secured and unsecured credit?

   Secured credit requires that you provide something of value to guarantee repayment of the loan. Unsecured credit does not require any type of repayment guarantee from the borrower.

4. Why is your credit report important?

   Your credit report is a record of your bill payment history. Lenders, employers, and landlords use it to get a sense of your ability to manage your household income and pay your debts. Typically, lenders will make decisions about your ability to repay a loan in the future based on your historical record of paying bills on time.

5. Is it possible for your credit report to contain errors?

   Yes. Get a copy of your credit report each year from all three credit bureaus and check it for errors. Take the time to correct any errors on your credit report so that it accurately reflects your ability to pay your bills on time.

6. If you are not able to pay a bill on time, what is the first thing you should do?

   Always contact the organization to which you owe money. Businesses want to be repaid, so they will often establish a payment schedule that will work for you. Working with the organization can help you avoid fees and having your overdue bills turned over to a collection agency.

Account statement – This is a record of your account activity over a specific period of time.

Annual percentage rate (APR) – The annual interest rate that reflects all of the costs of financing. This rate probably will be higher than the original interest rate quote, because it includes all other costs of getting credit, such as loan fees.

Assets – Financial assets are cash or something that can be converted into cash, such as a savings account, stocks, or real estate.

Automated teller machine (ATM) – ATMs are machines that provide many of the same services as a financial institution. Many financial institutions own ATMs to provide convenient service to their customers. There are various fees attached to using an ATM for financial transactions.

Available balance – This is the amount of money immediately available in your account. This amount does not reflect any withdrawals or deposits that have not yet cleared your account.

Balloon payment – This is the payment that is due at the end of a balloon loan. A balloon loan offers a low interest rate for short-term financing. At the end of the term, the loan requires refinancing or paying off the outstanding balance with a lump-sum payment.

Bounced check – A check that is returned to you because there is not enough money in your account to cover it.

Canceled check – Once a check has been processed and subtracted from the account on which it was written, it is called a canceled check. Canceled checks are often used as "proofs of payment," in place of receipts.

Cashier's check – This type of check is as good as cash. To issue a cashier's check, the financial institution will deduct funds from your account and write the check from its own account. There is usually a fee for a cashier's check.

Check register – A tool for keeping track of the daily balance in your checking account.

Clears – A check you write clears when the amount of the check has been withdrawn from your checking account by the financial institution.

Co-borrowers – Two or more persons who legally agree to take out and be responsible for paying off a loan together.

Collateral – Something of value that the borrower commits to guarantee repayment of a loan.

Commitment letter – A formal offer by a lender stating the terms under which a financial institution agrees to lend money. Sometimes it is called a "loan commitment."

Contingency – A condition that must be met before a contract is "legally binding," that is, before you must legally complete what was agreed to in the contract.

Credit – Credit is when you borrow funds with the intent to repay them.

Credit bureau – An organization that keeps records of people's repayment histories (i.e., credit reports).

Credit history – A list of your debts and regular monthly expenses, including how much you owe and how timely you make your payments.

Credit inquiry – When you apply for credit, the lender will request a copy of your credit report. Each time your credit report is requested from the credit bureau it is documented on your report as an "inquiry."

Credit rating – A rating that indicates how good a credit risk you are. Credit ratings are based on your personal credit history.

Credit report – A report that reflects a person's credit history. The lender orders this report from a credit bureau when you apply for a loan.

Credit score – A process used by lenders to evaluate a loan application. A credit scoring system is based on the lending organization's historical experience with borrowers.

Customer agreement – A document provided by financial institutions that describes the costs and features of their accounts.

Debit – A withdrawal from an account. If you write a $25 check, your account will have a debit of $25 when the check clears.

Debit card – A card that can be used at an ATM to conduct financial transactions or at a point of sale terminal (POS) to buy something.

Debt-to-income ratio – A ratio that compares a loan applicant's total monthly debt to their total income (total monthly debt/ total monthly income = debt-to-income ratio). Lenders use a debt-to-income ratio to help them determine an applicant's capacity to repay a loan. It is generally accepted that a person's total debt should not exceed 45 percent of the person's total income each month.

Debts – Money you owe.

Deposit – To put money into your account.

Depository services – Checking and savings account services offered by some financial institutions.

Default – Failure to pay back money. If you do not make agreed-upon payments, you default on your loan.

Direct deposit – Funds deposited directly into your account. With your agreement, payroll earnings, Social Security benefits, retirement earnings, and other checks you receive on a regular basis may be direct-deposited into your account.

Down payment – The part of a purchase price that you pay when you buy an item such as a car or a house. The lender usually seeks a down payment to show that you are willing to invest in a purchase.

Economy – The way a society organizes to meet the physical needs of its people.

Electronic funds transfer (EFT) – Money transactions to or from checking and savings accounts that do not require paper (checks or cash) but use computer technology. Examples include direct deposit, ATM, and debit card transactions.

Emergency reserve fund – Money you put into an account and save for an emergency.

Endorse – Endorsing a check is when you sign the back of a check that is made out to you in order to release the funds.

Expenses – The amount of money you spend on a regular basis.

Federal Deposit Insurance Corporation (FDIC) – The organization that insures accounts at federal government-regulated financial institutions for up to $100,000 per account.

Fixed expenses – Monthly household costs that do not change.

Flexible expenses – Monthly household costs that you can control, such as groceries.

Forgery – When a person purposefully tries to withdraw money from your account by pretending to be you.

Gross annual income – Total yearly income from all sources before taxes are deducted.

Hold – The number of days a financial institution will hold a check before crediting your account.

Installment credit – This type of credit allows you to borrow a specific amount of money at one time for a defined purpose. You make a set payment each month.

Interest – A fee paid for the use of money. A financial institution will pay you interest for keeping your money at their location. You will pay interest to a financial institution for the use of borrowed funds.

Joint applicant – When two or more people apply together for a loan.

Loan processing – The steps a lender takes to decide if a buyer can qualify for a loan.

Long-term goals – Savings goals you can accomplish by consistently setting aside money for several years.

Luxury expenses – Monthly costs that you choose, such as new clothes and going out for meals.

Market economy – An economic system where goods and services must be purchased from others.

Market value – The expected sale price of something.

Minimum balance – Necessary amount of money on deposit to qualify for special services.

Minimum payment – Smallest possible monthly payment.

Monthly statement – Account summary mailed monthly to a customer.

National Credit Union Share Insurance Fund (NCUSIF) – Insures accounts at federal government-regulated credit unions for up to $100,000 per account.

Net income – Your total income after taxes are taken out.

Noninstallment or service credit – Some businesses and utility companies offer this type of credit. It allows you to pay for a used service at a later date.

Nonsufficient funds (NSF) – A term meaning that the amount of money in your account is less than the amount you would like to withdraw. Also referred to as insufficient funds.

Nontraditional credit history – A credit history you can prepare if you do not have credit cards or have never had a loan. It can include receipts and canceled checks from your monthly payments for rent, utilities, and other bills.

Overdraft protection – A line of credit to cover nonsufficient funds.

Overdrawn – When more is withdrawn from an account than the existing balance.

Payment factor table – A table that you can use to calculate monthly payments and the cost of credit for installment loans.

Personal identification number (PIN) – Your password to your account at a financial institution. You can use your PIN to gain access to your account at an ATM or point of sale terminal (POS).

Point of sale terminal (POS) – A terminal consumers use to make purchases with a debit card at business locations.

Predatory lender – A lender that directs a borrower away from loans with more affordable interest rates. Instead, the applicant is offered a loan with a high interest rate, questionable fees, or unnecessary charges.

Principal – The amount you can actually borrow.

Promotional inquiry – When a company requests a copy of your credit report to "pre-approve" you for a credit card or special offer, it is recorded on your report. This type of inquiry is listed separately from credit inquiries that you request. Potential creditors will only see the credit inquiries that you initiate.

Purchase and sale agreement – A written contract that the buyer and seller sign. It includes all of the terms and conditions of the sale.

Qualify – To determine how much money you are able to borrow.

Reconciling – To balance your checkbook by comparing your check register with your account statement.

Repossess – When a financial institution takes ownership of an item that was purchased using credit because the borrower is not able to repay the loan.

Revolving credit – This type of credit allows you to borrow money at any time up to a set limit. As you pay the borrowed money back, it becomes available again to borrow (e.g., credit cards).

Savings goals – Statements about things you wish you could afford.

Secured credit – This type of credit requires that you provide something of value to guarantee repayment of a loan.

Secured credit card – This type of credit card requires that you deposit a certain amount of cash in a savings account to guarantee your credit card.

Service charge – Financial institutions sometimes charge fees for specific services. These fees will vary depending on the type of account you have. Ask about service charges and fees before you select a financial institution or a type of account.

Short-term goals – Savings goals you can accomplish in a few weeks or months by consistently setting aside money.

Signature card – A card that you sign when you open an account. This card is kept on file at the financial institution and used to verify your signature when you cash checks. This helps to prevent unauthorized people from gaining access to your account.

Spending plan – A strategy for saving and spending money. It can be used as a guide to help you track the flow of money through your household and how that money needs to be divided to meet expenses and savings goals.

Stop payment – An order by a customer not to release issued funds (i.e., not to cash a check).

Terms – The conditions of a loan, including the type, size of down payment, amount you can borrow, interest rate, and length of time to repay.

Tracking – To become aware of the flow of money through your household.

Unsecured credit – This type of credit does not require you to provide something of value to guarantee repayment of a loan.

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