

## Let's Talk About Credit!

### What is credit?

Credit is defined as the ability to obtain goods, money or services in return for a promise to pay back the amount borrowed (principal), plus additional money (interest), at a later date.

### Why is credit so important?

Credit offers convenience in making purchases, especially large purchases. Could you imagine if you needed to pay for the cost of your college tuition prior to starting? For most, without student loans college would not be possible.

Credit can also be used for emergencies that may arise. It is recommended that you have three to six months of your annual salary saved in a savings account for emergencies, but this is not

always as easy as it sounds. Credit allows you to pay emergency bills right away.

### What does your credit score affect?

Credit can impact your ability to obtain employment. In a lot of industries, the company will request your permission during the interview process to pull a credit report to see how financially responsible you have been in the past. If you do not have a good credit report, you could even be passed over for an interview!

Credit also impacts your ability to rent or purchase a home. To rent an apartment or house, your future landlord will run a credit report to check

your credit to see if you have had any repayment issues. Depending on your score, you could be told you do not meet the qualifications to rent. Lastly, credit will affect your cost of insurance. Your insurance agent will look at your credit score as part of determining what your insurance rates will be for your car insurance, renters insurance or homeowners insurance.



### In This Edition:

- ◆ **How Do You Establish Credit?**
- ◆ **Selecting the Best Credit Card for Your Needs**
- ◆ **To Finance or Pay Cash, that Is the Question**
- ◆ **10 Tips for Managing Your Student Loans**

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It is not intended to provide specific legal, tax or other advice to individuals.

## How Do You Establish Credit?

Establishing credit has changed over the last few years as a result of the Credit Card Act. Students under the age of 21 are now required to have a cosigner if they cannot show evidence of the ability to repay the credit charges independently. A cosigner is a second person legally obligated to make payments on the other's debt, if the initial person is unable to pay. As a result of these changes, students under the age of 21 will not receive pre-screened pre-approval offers unless the student specifically requests one of the three credit bureaus to share their information. Here are some recommendations to assist you in safely building credit.

### Start with a credit card:

A credit card is the easiest way to establish credit. There are two different options for credit cards—secured and unsecured. A secured credit card is a credit card that is backed by a savings account, which is used for collateral. Collateral can consist of monetary funds or property pledged to the issuing credit card company. If you do not pay the issuing credit card company back for the funds borrowed on the credit card, the collateral will become property of the company. A secured credit card can be established for as little as \$300. This card allows the borrower to prove their creditworthiness as they borrow money and pay it back. The risk for the issuing credit card company is low because they already have the funds for money borrowed. It will take you approximately a year of on-time payments on a secured credit card to build up a positive credit history to qualify for

an unsecured card. An unsecured credit card does not require collateral as terms for issuing the card. The card comes with an agreement that the borrower will repay the money borrowed.

### Use your credit card for small purchases:

Start using your credit card for small purchases like getting gas in your car or purchases at the grocery store. No matter what you charge, make sure you can pay back the amount charged. You want to show the credit card issuer you are responsible. It is recommended that you create a personalized credit spending rule to live by. Examples of spending rules are when the purchase is under \$20.00 always use cash, or once a month use cash to pay for the gas for your car. These small monthly savings will help with decreasing your total credit card bill due.

### Pay your credit card bill on time every month:

At the end of each statement cycle, you will receive your credit card statement with your total bill due. A statement cycle is the billing cycle for your credit card. Statement cycles can vary but typically are for 30 days, depending on the credit card issuer. Once you receive your credit card statement, do not delay in paying your bill. Paying your bill on time and in full is the best way to show your responsibility with using credit. Get in the habit of setting an alert reminder on your phone, calendar or online banking to pay. The

(cont.)

easiest way to pay your credit card bill is through online banking or by setting up an automatic bill payment. If you plan on mailing in the payment, make sure to allow 5-7 days for your payment to be received and processed to avoid late fees.

**Do not open too many new accounts:**

Experian, a company that provides consumer and business credit reporting, recommends you only open new credit accounts as needed. Building a smart credit history takes time. Ideally once you have established a credit card, a term loan is the next best way to assist in building your credit. Some examples of a term loan could be a car loan or personal loan. Do some research before you apply for an additional credit card or term loan. Whether you apply for a credit card or term loan, the company will check your credit which is considered a "hard inquiry." A hard inquiry is an inquiry where you have

requested your credit to be reviewed by the potential lender. Each hard inquiry counts as a single inquiry on your credit history. Hard inquiries can generally cause your score to drop and will remain on your credit report for 1-2 years.

**Keep your balances low:**

Some months might be tighter for cash than others and you might be tempted to just carry a balance for a month. What happens if you are tight with cash again the following month? This is how people end up getting into trouble with their credit cards. They assume the next month will be better and next month turns into the following month and it continues to snowball. One month short in cash can easily turn into four months, resulting in a high credit card balance that cannot be paid off. Remember... if you do not have the cash for it now, don't charge it.

**Check your credit report annually:**

Review your credit report annually for accuracy. If there is an error on your credit report, contact the credit reporting agency immediately. Get a free credit report at [annualcreditreport.com](http://annualcreditreport.com).

## Selecting the Best Credit Card for Your Needs

You have decided it is finally time to get your first credit card. How do you determine which credit card is the right card for you? Shop around to make sure you are finding a card that best meets your needs.

### Here are some tips to help you select a card:

#### ◆ Determine how you plan to use the card:

Do you anticipate paying off the balance on your card monthly? Then a card with a higher interest rate that offers rewards for making purchases may work for you. If you plan on keeping a balance, you want a card that has the lowest interest rate possible. Also find out if the card has an annual fee. Always compare the value of the rewards you expect to receive to the card rates and the annual fee you could be paying.

#### ◆ Know what you need to compare:

- **APR:** APR stands for Annual Percentage Rate and is the price you pay for borrowing money. For some credit cards, your APR is not determined until you apply for the card.
- **APR for Balance Transfers:** If you think you are going to move debt from one credit card to another, you will need to consider what the APR is for balance transfers. The rate for a balance transfer can vary from the standard APR on the credit card.
- **Penalty APR:** If you are late making a payment or if you charge over your limit, your APR could increase. Understand what would trigger an increase in your APR and how long the penalty APR would last.
- **Fees:** Compare the list of fees for each card. Some common fees include a cash advance fee, a late payment fee or an annual fee.

#### ◆ Shop around and ask for better deals:

Your bank is the best place to start when researching card options. Your existing relationship may qualify you for a special card or rate. You can also search online to see various credit card offers at once. Only apply for the credit card you need and want. If you apply for too many cards in a short period, it can negatively impact your credit score. If the credit card issuer approves you for a limit higher than you want, ask them to lower the credit limit to something you are more comfortable with. A credit limit is the maximum amount you can borrow on a credit card.

Some additional  
resources to aid you  
in your search are:



[Bankrate.com](https://www.bankrate.com)  
[Nerdwallet.com](https://www.nerdwallet.com)

## The 4 C's of Credit

### Character:

Character is what a bank looks at when you apply for a loan or credit card. A good credit history means that you have made your loan and credit card payments on time, showing you are financially responsible.

### Collateral:

Collateral is security you provide to the lender. You pledge against an asset you own such as a house, car or savings account. If you do not make your loan payments, the lender will take control of that asset to satisfy your debt.

### Capital:

The value of your assets and net worth.

### Capacity:

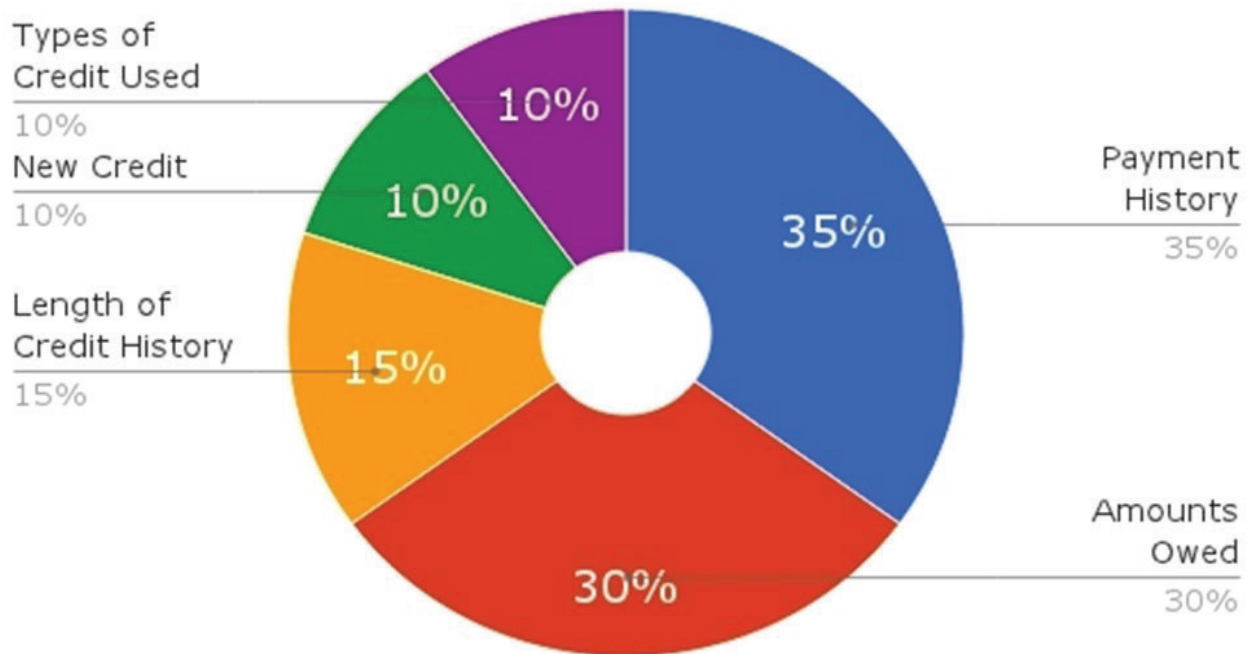
Your present and future ability to make your payments. This is determined by your job and other sources of income.





## What Is a Credit Score?

### FICO® Credit Scores



Source: <https://www.utahjustice.com/fico-credit-score-guide>



- 800 or higher - The FICO® Score is in the top 20% of U.S. consumers
- 740 - 799 - The FICO® Score is in the top 40% of U.S. consumers
- 670 - 739 - The FICO® Score is near the average score of U.S. consumers
- 580 - 669 - The FICO® Score is below the average score of U.S. consumers
- 579 or less - The FICO® Score is in the lowest 20% of U.S. consumers

Source: <http://viewfromthewing.boardingarea.com/2015/01/19/citibank-now-offering-free-fico-credit-scores-cardmembers/>

## To Finance or Pay Cash, that Is the Question

You finally have some extra money put aside and you unexpectedly need to make a large purchase. Do you use the funds in your emergency savings account, or do you finance it? Financial experts say there is no hard and fast rule; you need to look at all the factors. First, you need to look at your personal finances. Are you saving for retirement? What kind of debt and revolving debt are you carrying?

If you are making a purchase of something that will depreciate rapidly, paying cash is going to be your best bet. Why pay interest on something that is losing value over the life of the loan? If you purchase with cash, it can reduce your risk of buying or adding on to the cost of the purchase. Depending on the scenario, you may be able to negotiate the price or get a discount because you are paying cash.

You also need to consider interest rates. What would it cost you to borrow the money versus what you would make by investing the money? If you are looking to purchase a car from a dealership and they are offering you a loan rate around 2% but you can invest that same money in a savings account at 1%, you are basically financing at the cost of inflation. So it would make sense to take the car loan and build up your savings account.

Something else you should consider is making the purchase on your credit card and then paying off the balance. Depending on your credit card rewards, you may make money or earn other rewards from your purchase. Moreover, some credit cards offer protection on large purchases. For example, if your credit card offers travel protection insurance, you can charge your vacation on that card to use the protection insurance feature to your benefit.

Financing is best when the purchase is a necessity and you don't have the money, or the asset will grow in value. Financing a home or your college education makes sense because ultimately the house and your educational degree will be worth more than the interest you paid for them. You want to make sure you do not upset your normal cash flow. Try to keep your debt-to-income ratio around 30%. Your debt-to-income ratio is your monthly debts divided by your monthly gross income. Your monthly gross income is how much you make in a month. You can determine this by dividing your annual salary by 12.

## 10 Tips for Managing Your Student Loans

**1. Know your loans:** Keep track of the lender, your balance and your repayment time period. Keep a copy of the original signed paperwork. The best practice is to keep a folder or filing system for each loan and keep a spreadsheet with all of the basic contact and general information for each lender together.

**2. Know your grace period:** A grace period is how long you have from when you finish school to when you will need to make your first payment. For the Federal Stafford loans (subsidized and unsubsidized loans), you will have six months until your first payment. For Federal Perkins Loans, you will have nine months until your first payment. For Federal PLUS loans, you will have six months until your first payment. Don't be late on your first payment!

**3. Stay in touch with your lender:** If you move, change your phone number or e-mail address, let the lender know ASAP. You should open and read every piece of mail and e-mail from your lender. If you have problems with making your payments, talk to the lender.

**4. Pick the right repayment option:** Federal loans are automatically set up for a 10 year repayment period. If you need to extend your repayment period beyond 10 years, it will lower your monthly payment but increase your overall cost because of the extra interest paid. There are different options for repayment. An Income-Based Repayment Plan and a Revised Pay As You Earn will lower your monthly payments but stretch your loan out to 25 years. Private loans are not eligible for different payment plan options, though some lenders may allow you to modify your loans for a fee.

**5. Don't panic:** If you are having issues making your payments, you need to talk with the lender right

away. There are legitimate ways to temporarily postpone your federal loans.

**6. Stay out of trouble:** No matter what the case, do not ignore your student loans and the required payments. If you do not pay your student loans, they will go into default. If you default on your federal loans, the government will garnish your wages and seize your tax refunds.

**7. Prepay if you can:** If you can afford to pay additional principal on your student loans, you should. When making additional payments, make your regular payment on time and request your extra payment to be processed as a principal only payment. By applying extra money to the principal amount, you will save on interest during the life of the loan.

**8. Pay off the most expensive loan first:** If you are considering paying off a loan or paying extra each month, start with the loan that has the highest rate. Typically a private loan is going to be at a higher rate than a federal loan.

**9. To consolidate or not?** A consolidation loan will combine multiple loans into one convenient payment. If you are considering consolidating your federal loans, look first at the Direct Loan Program (<https://studentaid.ed.gov>). If you are considering consolidating your private loan, shop around for the best rate and terms.

**10. Loan forgiveness:** Depending on the career you choose, you could have some or all of your student loans forgiven. Public Service Loan Forgiveness is a federal program that forgives student loan debt remaining after 10 years if you work in government, nonprofit or other public service jobs. There are also forgiveness programs for teachers, nurses, AmeriCorps and PeaceCorps volunteers.



## Dollar Bank's 2020-2021 Tuition Scholarship Contest Newsletter #2 Review Questions:

Name: \_\_\_\_\_

Directions: Print this page. Answer the following questions based on the articles read in this Scholarship Financial News Newsletter. Save this review because it must be submitted with your essay to be eligible for the Tuition Scholarship Contest.

1. What is credit? \_\_\_\_\_

2. Credit can impact these three things: \_\_\_\_\_  
\_\_\_\_\_

3. What is the difference between a secured credit card and a regular credit card? \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

4. When using credit cards, you should make sure that your debt-to-income does not exceed \_\_\_\_\_%.

5. If you wanted to check your credit report for free, you can obtain a free copy from \_\_\_\_\_  
\_\_\_\_\_.

6. What is a grace period for your student loans and why is it important to know what your grace periods are? \_\_\_\_\_  
\_\_\_\_\_

**These answers must be e-mailed to [EducationalBankingProgram@dollarbank.com](mailto:EducationalBankingProgram@dollarbank.com).**

### In The Next Edition:

- ◆ Things to Consider When Selecting an Internship
- ◆ What Would the "Future You" Say About Retirement?
- ◆ The Value of Life Insurance Defined
- ◆ Easy Ways to Save Money
- ◆ Choosing the Right Job Offer