

Module 1

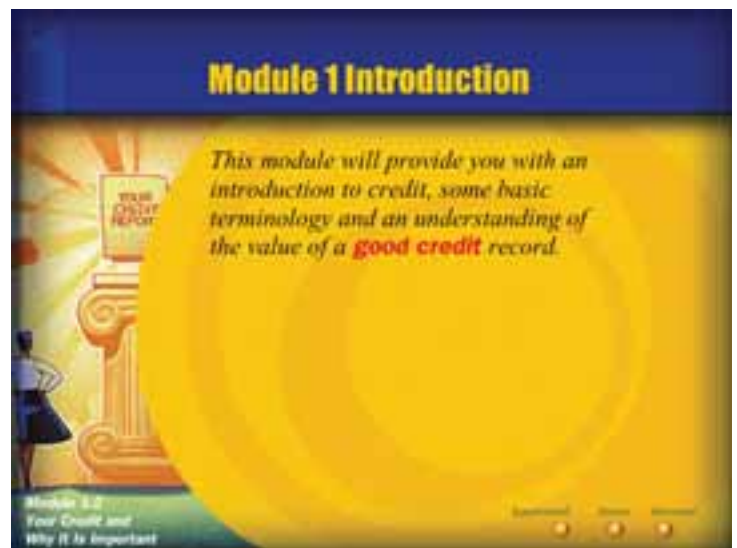
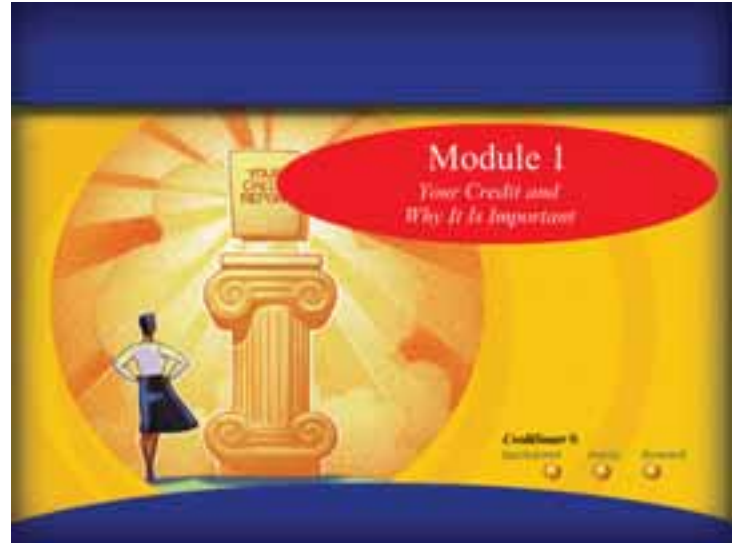
Your Credit and Why It Is Important



Module 1: Your Credit and Why It Is Important

► Presentation Slides

Module 1



What Is Credit?

- Credit is a privilege. The ability to borrow money at reasonable **terms** and **interest** rates cannot be taken for granted or assumed.
- Credit is extended based on a demonstrated willingness and ability to repay it.

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What Is Debt?

- Debt is when you owe money for the purchase of goods or services without immediately paying for them.
- You owe a debt when you use credit to make these purchases.

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Basic Terminology

- **Creditor** = Lender (the person or institution lending the money)
- **Debtor** = Borrower (the person using the money to pay for purchases or services)

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Basic Terminology



- **Interest Rate** is a charge for using someone else's money, typically indicated as a percentage.
- **APR** (Annual Percentage Rate) is the cost of credit expressed at a yearly rate which includes **all** costs and fees that a borrower is required to pay for a loan.

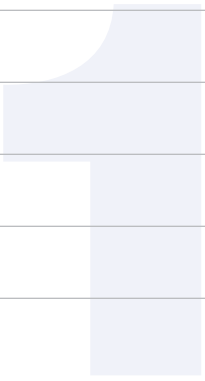
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Credit History and Credit Report



- A **credit history** indicates whether or not borrowed funds were paid back in a timely fashion or "as agreed." It also includes legal actions that have been taken, such as bankruptcy and foreclosure.
- **Lenders** have developed a system for documenting your credit history—a credit report.

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What Is a Credit Record?



- A **credit record** is a history of how you have managed your finances and repaid debt.
- It provides information on money that you have borrowed and a history of your payments.

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Why Is a Good Credit History Important?

- A good credit history increases the confidence of lenders or creditors.
- It allows you to:
 - Borrow for big expenses (car, home, education).
 - Borrow money at a lower cost.

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Why Is a Good Credit History Important?

- A good credit history is necessary to obtain lower fees and interest rates.
- The higher the interest rate and fees, the less funds you have available for savings and spending.

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Why Is a Good Credit History Important?

Loan rates are typically determined on the basis of your credit report and **credit score**.

- **"A"** loans are for people with good to excellent credit, and have the lowest interest rate.
- **"B"** or **"C"** or **"subprime"** loans have higher rates due to past or current credit problems such as **late payments**.

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Why Is a Good Credit History Important?



- Higher interest rates and fees will result in fewer disposable financial resources now and in the future.
- Over time, this will translate into the loss of thousands of dollars of potential savings.

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Benefits of Good Credit

Good credit will help you to:



- Fulfill your short- and long-term goals.
- Achieve your dreams.
- Have access to funds for emergencies.

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Good Credit Will Help You Achieve Short-Term Goals



- Renting an apartment.
- Opening a checking account.
- Getting a new job (which may require a credit check).
- Establishing utility services in your name.
- Making a major purchase (such as furniture or an automobile).
- Keeping your other rates low (such as auto and homeowner's insurance).

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Despite Financial Difficulties



Payment of debt obligations *must* become a number one priority.

Failure to do so will make it *difficult and costly* for you to borrow for the things that you need for yourself and your family, such as a home, education or medical care.

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Tips for Maintaining Good Credit



Before taking on additional debt, ask yourself the following questions:

1. Do I really need this item right now or can I wait?
2. What is the true (total) cost of using credit?
3. How much is the monthly payment and when is it due?
4. How many months will I have to make this payment?
5. Can I afford the monthly payments?
6. What will happen if I don't make the payments on time?

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SUMMARY



- Managing your finances and working toward financial goals and stability requires discipline and knowledge of how to maintain a good credit record.
- An impaired credit record or payment history may prevent you from saving money, achieving goals and accumulating wealth.

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► **Questions to Think About Before Taking on Additional Debt**

In order to maintain good credit, it may be helpful to ask yourself the following questions before taking on additional debt:

- 1) Do I really need this item right now or can I wait?
- 2) What is the true (total) cost of using credit?
- 3) How much is the monthly payment and when is it due?
- 4) For how many months will I have to make this payment?
- 5) Can I afford the monthly payments?
- 6) What will happen if I don't make the payments on time?



► **The Impact of Interest Rates on the True Cost of a Loan**

The following sample loan amortization provides you with an illustration of how interest rates impact the true cost of borrowing money.

Example #1: Car Loan

A \$20,000 car loan at 8% for 5 years, costs \$405.53 per month. After making all 60 of the payments, (12 months times 5 years) the total paid is \$24,331.67.

A \$20,000 car loan at 14% for 5 years, costs \$465.37 per month. After making all 60 of the payments, (12 months times 5 years) the total paid is \$27,921.90.

The difference from 8% to 14% means that you will pay \$3,590.23 in extra interest.

Example #2: Home Mortgage

A \$125,000 home mortgage at 7% for 30 years, costs \$831.63 per month for principal and interest. After making all 360 of the payments, (12 months times 30 years) the total paid is \$299,386.12.

A \$125,000 home mortgage at 12% for 30 years, costs \$1,285.77 per month for principal and interest. After making all 360 of the payments, (12 months times 30 years) the total paid is \$462,875.66.

The difference from 7% to 12% means that you will pay \$163,488.86 in extra interest over the life of the 30-year loan.

► Sample Amortization Schedules

The following provides a chart of some examples of the costs of credit. The chart contains three different loan amounts (\$10,000, \$12,000, and \$15,000) borrowed at rates of 10% and 25% for the same length of time (five years or 60 months). Note how drastically the monthly payment, the finance charge, and the total cost of the purchase changes from 10% to 25%.

Total Amount Financed	(APR) Annual Percentage Rate	Length of Loan in Months	Monthly Payment	Total Finance Charge	Total Cost of Purchase
\$10,000	10%	60	\$212.47	\$2,748.23	\$12,748.23
\$10,000	25%	60	\$293.51	\$7,610.79	\$17,610.79
\$12,000	10%	60	\$254.96	\$3,297.87	\$15,297.87
\$12,000	25%	60	\$352.22	\$9,132.95	\$21,132.95
\$15,000	10%	60	\$318.71	\$4,122.34	\$19,122.34
\$15,000	25%	60	\$440.27	\$11,416.19	

It is important to note that no matter what the actual interest rate is, it is **ALWAYS** a good practice to pay more than the “minimum amount due” as stated on the monthly bill. This practice will help you to reduce your debt more rapidly and can save you hundreds or thousands of dollars in interest payments.



For example, a person who charges \$2,000 on a credit card with 19.8% interest and an annual fee of \$40 would end up paying approximately \$8,202, over 31 years, if he or she made only the minimum monthly payment. By doubling the minimum monthly payment, this person could be out of debt in three years!

► Examples of a Home Mortgage Payment

(visit www.FreddieMac.com/calculators to use a mortgage calculator)

This next chart illustrates the difference interest rates make on the cost of purchasing a home.

There are three loan amounts listed in this example: \$75,000, \$100,000, and \$125,000. Each amount is calculated at both a rate of 7% and 12% over a period of 30 years (360 months).

(As you will learn from the workshop, “subprime” mortgage rates—due to impaired credit—can cost you a great deal of money.)

Note how much borrowing power you lose by paying 12% versus 7%. In the chart, you will see that \$125,000 borrowed at 7% will cost \$196.98 per month **LESS** than borrowing only \$75,000 at 12%.

Total Amount Financed	(APR) Annual Percentage Rate	Length of Loan in Months	Monthly Payment*	Total Finance Charge	Total Cost of Purchase
\$75,000	7%	360	\$498.98	\$104,631.67	\$179,631.67
\$75,000	12%	360	\$771.46	\$202,725.40	\$277,725.40
\$100,000	7%	360	\$665.30	\$139,508.90	\$239,508.90
\$100,000	12%	360	\$1,028.61	\$270,300.53	\$370,300.53
\$125,000	7%	360	\$831.63	\$174,386.12	\$299,386.12
\$125,000	12%	360	\$1,285.77	\$337,875.66	\$457,875.66

* For comparison's sake, the numbers in the fourth column reflect principal and interest only. A typical mortgage payment includes principal, interest, taxes, and homeowner's insurance (PITI).

It is also important to note that in addition to PITI, homebuyers who pay less than 20% down may be required to purchase mortgage insurance.

