Delray Credit Counseling, Corp

DCC DOLLARS & $ENSE

Volume 11, Issue 1

October 1, 2003

Special points of interest:

- Facts and fallacies on credit
- Establishing New Credit
- Understanding the types of credit available.

Fact & Fallacy

Fallacy: A bad score now will prevent me from getting credit forever.
Fact: A credit score only takes into consideration your risk at a given time and is changed frequently when new information is added. As time passes, negative marks will have less of an impact on your overall score. For example, a sixty day late payment three years ago will effect you less than a thirty day late payment one month ago.

Understanding Basic Types of Credit

Installment Loans: are issued by lenders on the basis of credit worthiness with a fixed repayment schedule.

- ❖ These are typically calculated with a simple interest rate and a fixed payment amount each month.
- ❖ With a monthly payment schedule that is fixed, a certain amount is paid towards principle and a certain amount toward finance charges each month.
- ❖ An installment loan may or may not have collateral attached. If collateral is held on the account and payments are not made as scheduled, the lender may reclaim the property held as collateral. If no collateral is held on the account and payments are not made the lender will have less recourse if payments are not made as scheduled. This could include legal action if deemed necessary.
- ❖ Fees are typically applied if payments are not made as scheduled, but installments loans generally have a grace period.

Credit Cards: are issued by a variety of lenders. This can include your bank where you keep your savings, or a lender that solely deals with credit cards.

- ❖ Credit cards allow consumers to make transactions based solely on credit.
- ❖ The purchases made are added to the balance each month, along with any finance charges for that billing period.
- ❖ Credit cards typically have a credit limit placed on them. This is usually determined by the consumer's credit rating.
- ❖ Annual Percentage Rate

Establishing New Credit

The first thing a person looking into credit for the first time will see is that no credit can be worse than bad credit. Lenders look at your previous credit history when determining if they will extend credit to you. If you're looking to open your first credit account, this could be a redundant cycle.

The first thing a consumer can do is open a savings and checking account. You want to have a savings account and you'll need the checking account to pay your bills. The only benefit to starting your credit file is that you have a "clean slate" with no mistakes and it's best to keep it that way. Remember that payments need to be made on time. With no credit history to reference, you don't want what you do have available to be negative.

Understanding the Basics Cont.

(APR) on a credit card is computed as compound interest, because of that, the amount of the monthly finance charges will fluctuate from month to month.

- The monthly payment on these accounts will be variable, depending upon the balance. Each month a different amount goes towards principle and interest.
- Late payments on these types of account are generally penalized with a late fee that could be as much as $39.00 if the payment is even a day late.

Merchant Charge Cards: are extended by retailers for explicit use in their stores.

- These accounts are typically treated the same as a credit card account in regards to credit limit, APR structures and payment requirements.

Lines of Credit: may be extended by a number of financial institutions.

- A line of credit is simply an account held with a bank, maintaining a consistent credit limit that can be borrowed from as needed.
- A line of credit will have an APR applied to the balance each month. The percentage rate would be fixed, however the amount of finance charges on the account would vary depending on the balance.
- For example, a consumer may have a line of credit for home repair with a limit of $5,000.00 where they borrow periodically for repairs and then repay on a monthly payment schedule. The payment schedule will fluctuate each month, as will the amount of the finance charges.

Mortgages: are issued to assist consumers in purchasing a home. Unless you are an independently wealthy person, you will need a mortgage for the purchase price of a home. There are several types of mortgages available that a consumer may choose from.

Establishing New Credit Cont.

One of the best ways to start to establish credit is with a secured a credit card. This is a credit card issued by a lender with a security deposit that you pay prior to receipt of the card. Your credit limit on the account will vary depending on the amount of your deposit. Typically, these carry an average interest rate and any other finance charges the bank may apply. With a secured Visa/ MasterCard, you have all of the charging privileges of any other credit card. How you manage that credit card will reflect in the payment history on your credit report. You are using your own money and paying interest on it, but you're paying to establish your credit history. Which is a worthwhile investment.

While a secured credit card is typically easier to acquire for someone with little or no credit history, an unsecured credit card is also an option. Most credit cards offered by banks are unsecured, meaning there is no collateral attached to it. Unsecured credit cards are riskier than secured credit cards so by managing an unsecured credit card properly, you can appear as a better credit risk to lenders. Unsecured credit cards have a credit limit based on credit history and generally carry the same finance charges a secured credit card.

When establishing a credit history, what you really want to portray is that you have requested and used credit as it was needed. Credit is necessary for many things, by accepting credit you truly need and managing it properly, you will show yourself as a good credit risk.