



The Financial Puzzle: Using Credit Wisely

Brooke Kusch, MS
Family Financial Planning

Sissy R. Osteen, Ph.D., CFP®
Associate Professor and Resource Management Specialist

Oklahoma Cooperative Extension Fact Sheets
are also available on our website at:
<http://osufacts.okstate.edu>

Many households rely on credit. It is easy to put a purchase on a credit card and forget about the cost...until the bill arrives. Credit can be easy to obtain and easy to abuse. Your financial security can be affected by the choices you make regarding credit. Below you will find information that can help you make better decisions about using credit.

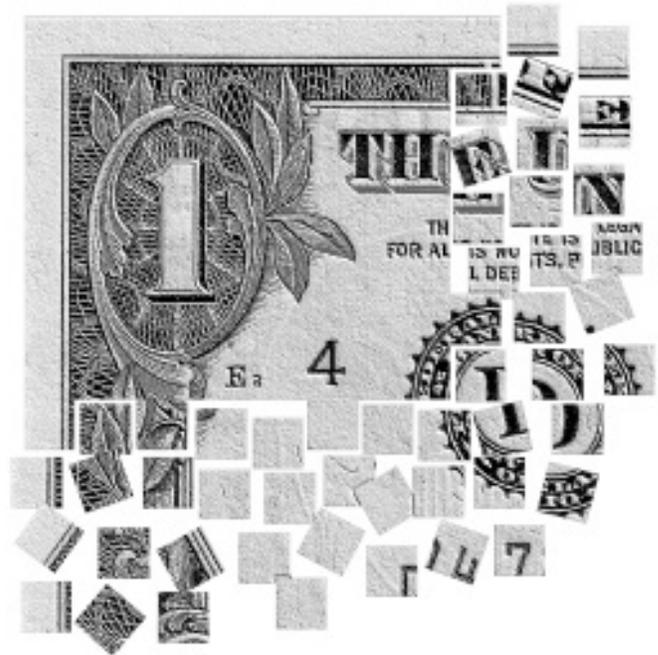
Why Use Credit?

Credit comes from the Latin word meaning "trust." This means that a lender trusts you to repay them for the use of their money. The way that you earn the trust of the lender is to prove that you have the capacity to repay a debt. As time goes on, you continue to earn that trust by making credit payments on time. Your creditors provide details about your payment history to a credit-reporting agency and that information is what can be found in your credit report. Over time, this information is used to calculate a credit score that reflects how risky it is to loan you money. This measure of trust affects many aspects of your financial life including whether or not you will buy a house or car or go to college.

Before deciding whether to open a credit card account or take out a loan, it is important to know that it is the best option for you. There are advantages and disadvantages to using credit.

Advantages:

- Credit provides the ability to make larger purchases that could not be paid for all at once.
- Credit is safer than using cash. If cash is stolen or destroyed it cannot be replaced.
- If a credit card is lost or stolen, and it is reported to the credit card company in a timely manner, you are typically only responsible for up to \$50 of fraudulent charges.
- The Fair Credit Billing Act allows consumers to withhold payment on damaged or poor quality goods or services purchased with a credit card if the consumer has tried to solve the issue with the merchant before withholding payment.
- Credit card companies often offer special services to travelers. These may include access to customer service 24 hours a day 7 days a week, flight insurance for tickets bought with the card, trip interruption services, card replacement for lost or stolen cards, rental car insurance, and even airline mileage credit.



- Larger loans like car loans, student loans, and home mortgages allow consumers to pay debts over a longer period of time.
- Some retailers allow special financing with no interest rate if the balance is paid in full during the repayment period.

Disadvantages:

- Credit costs. Anytime you use credit to purchase something, you are paying to use someone else's money. Annual membership fees, late fees, and interest on balances all add to the cost of the original purchase.
- Using credit rather than cash can make it easier to overspend. Credit cards are often used when cash is not available.
- Many people make only the minimum payment required by the credit card company. The minimum payment may cover the interest and a small amount of principal leading to a longer repayment period and increases the cost.
- Interest rates can change on credit accounts. Variable rates can lead to higher interest charges.

- Failing to make payments on time can adversely affect credit scores and interest paid on future loans.

Annual Percentage Rates

You can never assume that creditors charge 'pretty much' the same rate. All credit lenders charge an Annual Percentage Rate or APR. This is the interest rate charged per year for using credit plus any fees. Be sure to read all the terms of use that disclose rates and fees. Credit card terms can vary according to the type of transaction. For instance, cash advances generally have a higher interest rate than regular purchases. Cash advances can also lead to immediate interest charges.

Think Carefully about Your Use of Credit

Only you and your family can decide if you should purchase something on credit. There are times when credit is a good option. You must analyze your family's personal income and expenses, your current amount of debt as a percentage of assets, the stability of your financial situation, and the size of your emergency fund. Will adding additional debt stretch your finances too thin, or will you be able to manage if something unexpected happens?

How Much is Too Much?

How do you know when you are overusing credit? The first hint of trouble is usually a feeling. Getting a picture of how credit fits into your financial situation is a matter of confirming the numbers. The first step in doing this is to prepare a list of your expenses. Extension Fact Sheet T-4149 *The Financial Puzzle: Putting the Pieces Together* is available to help you with your current financial situation. Available online at www.fcs.okstate.edu

Once you make a list of expenses, you can see how much income is committed to expenses and how much is left to make credit payments. As a general rule, not more than 20 percent of your take home pay should be committed to debt payments, excluding your mortgage. For example, someone with a monthly take home pay of \$2,000 should be using no more than \$400 on installment payments a month. The amount spent on a mortgage can lessen the amount available for other debts. The standard housing affordability guideline specifies no more than 30 percent of monthly gross income should go for housing expenses. Additionally, no more than 36 percent should be spent for total debt (housing expenses plus other debt). This only allows 6 percent for debt that is not related to the mortgage. These guidelines can help consumers identify problem areas and know when they should take action to address credit issues.

Danger Signs

- You are only able to make the minimum payments.
- You have a sense of dread when you get your credit statements or you leave them unopened.
- You are charging more than you can pay off each month.
- You are using credit and cash advances to purchase items that used to be purchased with cash, such as groceries, gas, and clothing items.
- You have a credit balance that rarely decreases.
- You have reached or are near your credit limit.
- You are applying for new cards and transferring balances.

- You are draining your savings to pay bills.
- You are taking out loans to pay bills.
- You are making late payments.
- Unexpected expenses, like medical bills, make payments on credit accounts almost impossible.

Addressing Credit/Debt Problems

If you find yourself unable to make payments you should contact your creditors sooner rather than later. Before you call the creditors you need to think carefully about how you are going to explain your current financial situation. First, clarify your money picture by gathering accurate figures about your finances. You need to determine your essential expenses, and then see how much you feel you can allocate to paying down your debts. Any child support or other court-ordered expenses are high priority expenses and must be considered to avoid further problems. Debts like your mortgage and vehicle loans take priority as well because they are secured by property. After those expenses are paid use the remainder to begin paying off your credit card debt.

Next, summarize your problem and propose a solution. Be aware that if you propose to pay less than the minimum payment, the creditor may respond with consequences you were not prepared for. You may need to be prepared to pay cash if a debt settlement is offered.

You may be able to ask for special help, such as lowering your interest rate or stopping charges of certain fees. Lastly, if you have been with the company for many years and have always paid your bill on time, bring this, and any other favorable information to the creditor's attention.

You are now ready to get your notebook and pen and pick up the phone. Once you get through the automated phone system, the first person you talk to will be a customer service representative. Determine if this person will be able to help with your request. Ask the representative if they have the authority to change an interest rate and terms. If the answer is yes start talking, if the answer is no, then ask to be transferred to someone with that authority. Once you reach someone who can help, you must keep a two-way conversation open. Be ready to negotiate if they do not accept your initial terms. Keep your composure. It is easy to get flustered, but aggressive behaviors are rarely effective methods for achieving your goals.

Keep notes of the conversation, dates and times of contacts and the persons to whom you spoke. You must keep your end of any deal by providing documentation or follow up that you promised to the creditor. Keep in contact with the creditor and let them know of any changes immediately. Most agreements require the consumer to follow up in writing. So do this as soon as possible. Equally important is to request a written letter from the creditor accepting the terms of the agreement reached.

Credit is a Responsibility

Credit is a huge responsibility. It can be helpful if used and managed properly. You and your spouse or family should discuss how much you could manage, and if using credit is the best option. The following are steps you can take to ensure that you are being a responsible user of credit:

- Shop around for the best interest rate on loans and credit cards by comparing the annual percentage rate (APR).

- Never take on a larger amount of credit than you can handle.
- Always make your payments on time.
- Carefully read your credit contract to determine your responsibilities AND your rights.
- Keep a copy of your account numbers and customer service phone numbers in a safe place in case your cards are lost or stolen.
- Report any problems with your card as soon as possible.
- Before traveling be sure to notify your credit card company, so they do not deny a charge when you try to use your card outside of your normal area.

Credit Resources

Sometimes despite all of their best efforts, consumers find themselves in debt that they cannot manage. There is help. Reputable credit counseling agencies can help you identify credit issues and work through them. The United States Department of Justice maintains a list of credit counseling agencies found at www.usdoj.gov/ust .

Once you have found a credit-counseling agency in your area, check with your state Attorney General and Better Business Bureau to see if the agency has had any complaints filed against them. You can expect a reputable agency to help with developing a family spending plan and determining a strategy for getting out of debt. The agency may offer educational classes to keep you on track.

The Federal Trade Commission oversees legislation related to credit and many resources can be found at the commission's website at www.ftc.gov

When it comes to the financial puzzle, credit can be a good tool when it is used wisely. Knowing when to use credit and when to limit your use is important in maintaining financial security. Ultimately, knowing that there are trained and skilled people who can help you when you are having trouble might be the most valuable tool of all.

References

www.ftc.gov

The Oklahoma Cooperative Extension Service

Bringing the University to You!

The Cooperative Extension Service is the largest, most successful informal educational organization in the world. It is a nationwide system funded and guided by a partnership of federal, state, and local governments that delivers information to help people help themselves through the land-grant university system.

Extension carries out programs in the broad categories of agriculture, natural resources and environment; family and consumer sciences; 4-H and other youth; and community resource development. Extension staff members live and work among the people they serve to help stimulate and educate Americans to plan ahead and cope with their problems.

Some characteristics of the Cooperative Extension system are:

- The federal, state, and local governments cooperatively share in its financial support and program direction.
- It is administered by the land-grant university as designated by the state legislature through an Extension director.
- Extension programs are nonpolitical, objective, and research-based information.
- It provides practical, problem-oriented education for people of all ages. It is designated to take the knowledge of the university to those persons who do not or cannot participate in the formal classroom instruction of the university.
- It utilizes research from university, government, and other sources to help people make their own decisions.
- More than a million volunteers help multiply the impact of the Extension professional staff.
- It dispenses no funds to the public.
- It is not a regulatory agency, but it does inform people of regulations and of their options in meeting them.
- Local programs are developed and carried out in full recognition of national problems and goals.
- The Extension staff educates people through personal contacts, meetings, demonstrations, and the mass media.
- Extension has the built-in flexibility to adjust its programs and subject matter to meet new needs. Activities shift from year to year as citizen groups and Extension workers close to the problems advise changes.

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