



UNDERSTANDING
CREDIT

PERSONAL
FINANCE FOR
MILITARY LIFE





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UNDERSTANDING CREDIT



Credit cards. Mortgages.
Student loans. Sometimes it just
makes sense to buy something
now and pay for it later. But you
also have to pay for the privilege
of using someone else's money.
“Credit” and “Debt” are two
sides of the same coin.

QUESTION

Why should you care about your credit reputation?

ANSWER

Because banks, employers, merchants and landlords care. Often, they look at a credit report as a measure of how responsible someone is with their finances.

There's nothing wrong with buying on credit, as long as you do so responsibly and remember that it's not really your money. In other words, you're going to have to pay it back — plus interest. Credit is just another way of describing a loan — and the faster it's paid off, the better. In fact, buying something on credit and then paying it off quickly can actually be beneficial, because it helps you build a good credit reputation.



BUILD CREDIT NOT DEBT

When you buy on credit or take out a loan, you incur debt. Think of “debt” as everything that you owe anybody — the total cost of things purchased on credit plus any interest or fees. Responsible individuals incur debt every day to acquire big-ticket things that they need now, but that cost too much to pay for all at once. New homes, a college education, a new vehicle — most people buy these on credit. It’s when they get careless with debt, without a realistic plan to pay it back, that they can get into trouble.

MAKE A GOOD FIRST IMPRESSION

Your credit reputation can influence people’s decisions to:

- » Hire you for a job.
- » Grant you a job-related security clearance.
- » Rent or sell you a home.
- » Finance a vehicle purchase.
- » Extend affordable insurance for your vehicle or home.
- » Offer you a loan at the lowest rate.

See “Get Your Free Credit Report” on pg. 15

CASH OR CREDIT? IF LIVING BEYOND YOUR MEANS IS A CONCERN, THEN CONSIDER USING CASH INSTEAD OF CREDIT.

CREDIT CARD USES THAT COULD SIGNAL TROUBLE

- » Airline tickets for a weekend trip back home to see family
- » Replacing your broken cell phone
- » Dinner and drinks this weekend
- » Celebrating your best friend’s wedding next month

It’s not that using a credit card to pay for these things is necessarily bad, it’s that each of these expenses could be handled in a better way. For instance, airline tickets back home to visit family is something that could be planned for and saved for instead of charging it and paying for it later. The same is true for celebrating a friend’s wedding. Money to replace a broken cell phone should come from an emergency fund. And weekend entertainment is an expense for which you should have a budget category.

If your credit card is your answer to these types of things, you could be headed for financial trouble.



HEALTHY HABITS

The following healthy credit habits can improve your credit reputation:

- » Pay bills on time.
- » Do not skip payments.
- » Pay off credit cards in full each month. If you have a balance, keep it as low as possible. Never max out your available limit.
- » Do not apply for credit you do not need.
- » Know the due date, terms and conditions of your credit cards and loans. If you have questions, ask your creditors for an explanation.
- » Keep credit card and loan information in a safe, secure place.
- » Keep your receipts and compare charges when your billing statements arrive. Call your company immediately if there is a discrepancy.

A strong financial foundation with a responsible budget, emergency fund, and protection for unexpected events empower you to make wise credit decisions.

**GOOD CREDIT ISN'T SOMETHING YOU CAN BUY,
IT'S SOMETHING YOU MUST EARN.**



SHOPPING FOR A LOAN



Shopping for a loan is a lot like shopping for a vehicle. Price, quality, practicality, and the reputation of the lender are important considerations.

THINGS TO KEEP IN MIND:

- » Don't be tempted to stretch out a loan term just to keep the payment lower.
- » The longer you take to pay, the more you pay.
- » It's important to know the total cost of the loan (interest costs over the life of the loan plus any fees).
- » Making the purchase now isn't always worth the trade of the loan costs.
- » The lender's reputation matters. Do you trust them?
- » Watch out for short-term, high-cost "payday loans" or any scheme that offers "cash now" in return for a personal check for the borrowed amount, plus a fee.

BEFORE TAKING A LOAN, CONSIDER THE 3 Cs:

CASH FLOW. Will the monthly payment fit prudently into your budget? Or will it stretch the limits of your cash flow today or any time in the future until the loan is paid off?

COMMITMENT. How long is the term of the loan? Does it make sense to take on that long of a commitment? Will your loan still seem like a good idea if your situation changes before it's paid off?

COST. Does borrowing the money still seem attractive when you add up the total interest and potential fees you'll pay over the life of the loan? Remember, there's more to borrowing money than whether or not you can afford the payment.

THE BOTTOM LINE:

Look for the lowest interest rate. Know the total cost of the loan. Don't just focus on the payment.

COMPARING CREDIT CARDS



Free travel miles or cash back on every purchase! These benefits sound great, but avoid basing your choice of credit card exclusively on promotions or special offers.

Banks and credit card companies spend a lot of marketing money trying to convince us to get their credit cards. But don't let the fancy marketing cause you to make a bad financial decision. Instead, focus on the money; specifically, how much money the card is going to cost you.

Understand the interest rate, the annual fees, and any other cost you'll have to pay to use the card. Then worry about the perks. In most cases the more bells and whistles a card has, the more it will cost you.



CREDIT CARD COMPARISON CHECK LIST:

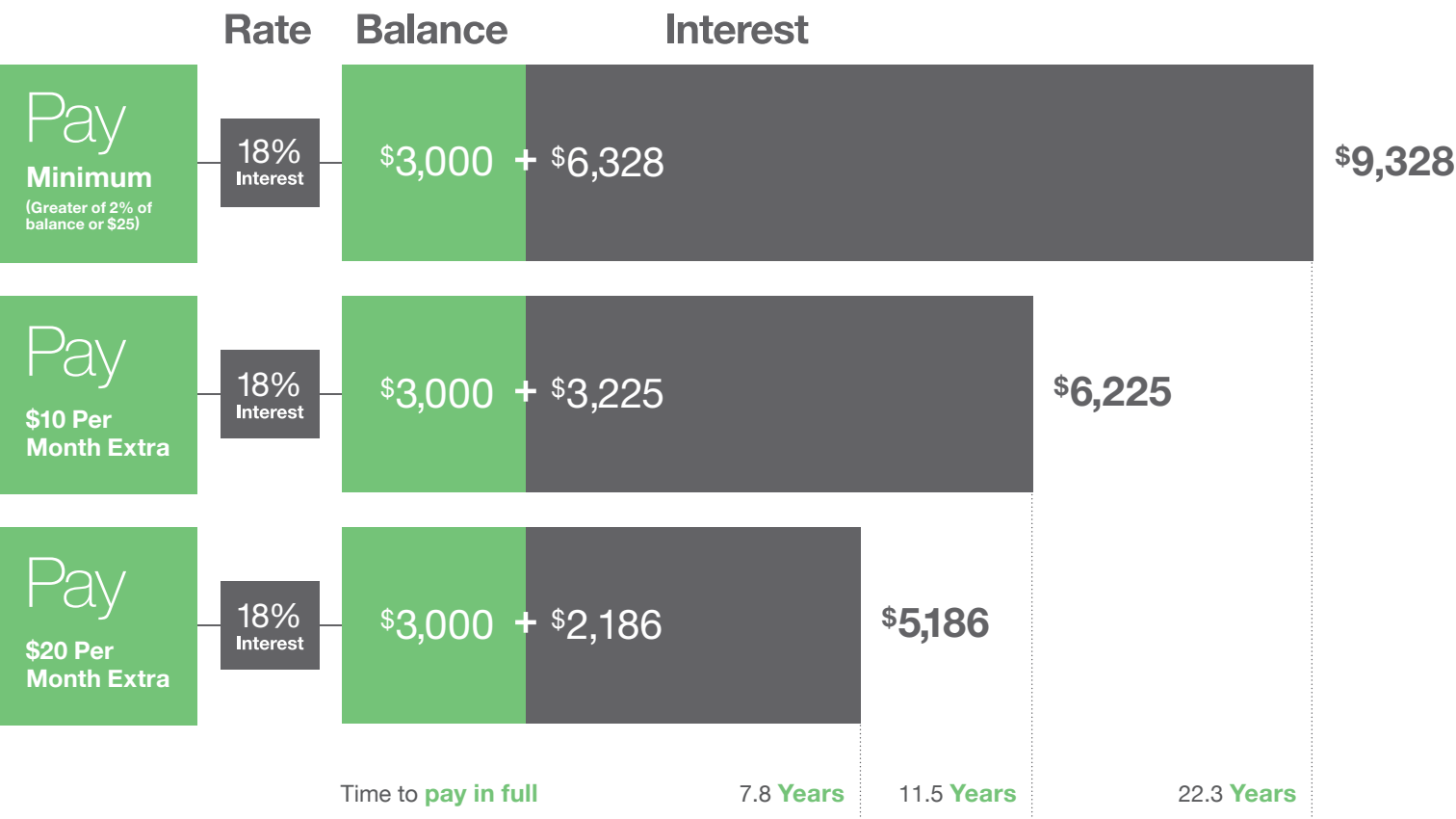
- ☒ **APR (ANNUAL PERCENTAGE RATE)**
Use this number to compare which credit cards to use; it represents the actual yearly cost and includes basic fees.
- ☒ **PENALTY APRS**
Some credit card contracts allow issuers to increase the interest rate if a payment is late.
- ☒ **FEES**
Compare penalties, over-limit fees, and annual fees.
- ☒ **GRACE PERIOD**
How many days can you take to pay the credit card bill before they start charging interest and/or late fees?
(This is generally a minimum of 21 days).
- ☒ **BENEFITS**
Does the card offer things like frequent flyer miles, cash points, or access to an ATM?

THE BOTTOM LINE:

Look for the lowest cost credit card you can find and pay it off at the end of every month. Discipline is key when using credit cards.

HOW CREDIT CARD DEBT COSTS YOU

Always pay more than the minimum. In this example, paying only the minimum each month will take about 22 years to pay off the balance and cost more than twice the original charge. Even paying just a little more each month can make a big difference.



USING CREDIT CARDS WISELY

It's a good idea to limit the number of credit cards you use. It's easier to keep track of spending, it looks better on your credit report, and it reduces the temptation to accumulate debt.

WITH CREDIT CARDS, LESS IS MORE.

Once you begin to establish a credit history, it should become easier to get credit card offers. But that doesn't mean you should accept every offer that comes your way since doing so could negatively impact your credit efforts.

- » All of your credit cards, including credit card applications, appear on your credit report. Holding too many cards could lower your credit score.
- » Applying for multiple credit cards could decrease your chances of being approved for any of them.
- » Using too many credit cards increases your "credit utilization" percentage — a number that lenders look at to compare your outstanding debt to the total amount of credit available to you (your credit card limits).

NEED A SECURED START?

If you're unable to qualify for a regular credit card, try starting with a secured card from your bank or credit union. The lender will typically require you to deposit money equal to your credit limit. Be sure to keep your balances low and make scheduled payments on time to improve your credit history.

Once you've proven yourself as a responsible credit card user, your secured issuer will often be willing to offer you a regular credit card that doesn't require the deposit.

CREDIT REPORTS AND SCORES



By now you know a good credit reputation is important. Your reputation is commonly measured by your credit report and credit score. So what factors go into determining a credit score? More importantly, what behaviors can you implement today to make a change for the better?

YOUR CREDIT REPORT

Your credit report is a record of your payment history with creditors. It is this report that employers, lenders, landlords, insurers and other businesses evaluate to make decisions about your creditworthiness.

It shows the following:

- » How much credit you are using.
- » How well you pay your debts.
- » Who is inquiring about your credit.
- » Information on bankruptcies.
- » Federal income tax liens.

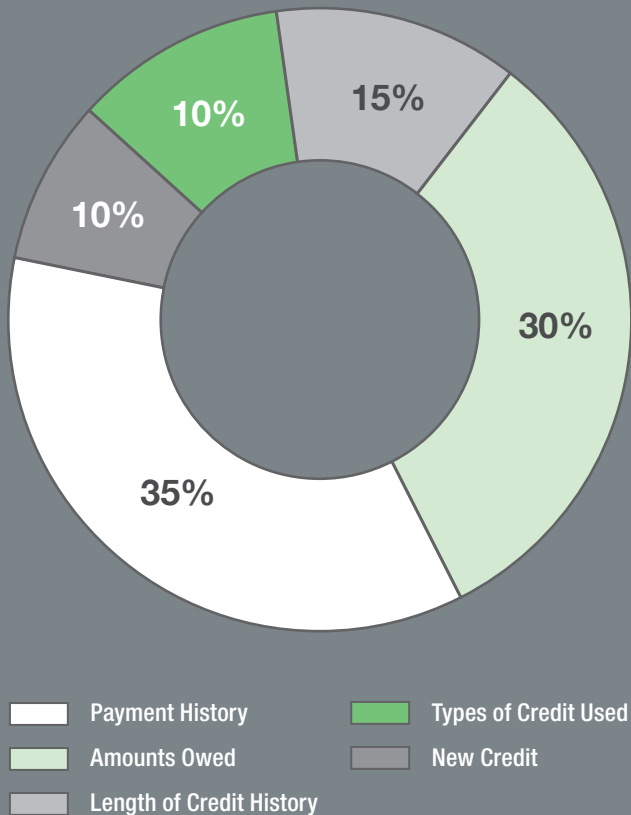
You can request your free annual credit report through the Annual Credit Report Request Service, a centralized contact created by the three nationwide consumer reporting agencies, Equifax, Experian and TransUnion. To request your free annual credit report, visit annualcreditreport.com

Review your credit report annually for accuracy and any changes that may indicate fraudulent activity.

In addition to your credit report, creditors may look at your credit score, a three-digit numerical summary of your credit report. The higher your score, the better.

FACTORS DETERMINING CREDIT SCORE

FICO MODEL:



No single factor determines your score. But one or more of the factors may affect the final score more than others, depending on the overall information in your credit report.

Your score today could be different from your score three months from now. Ordering a copy of your own credit report or credit score does not impact your score.

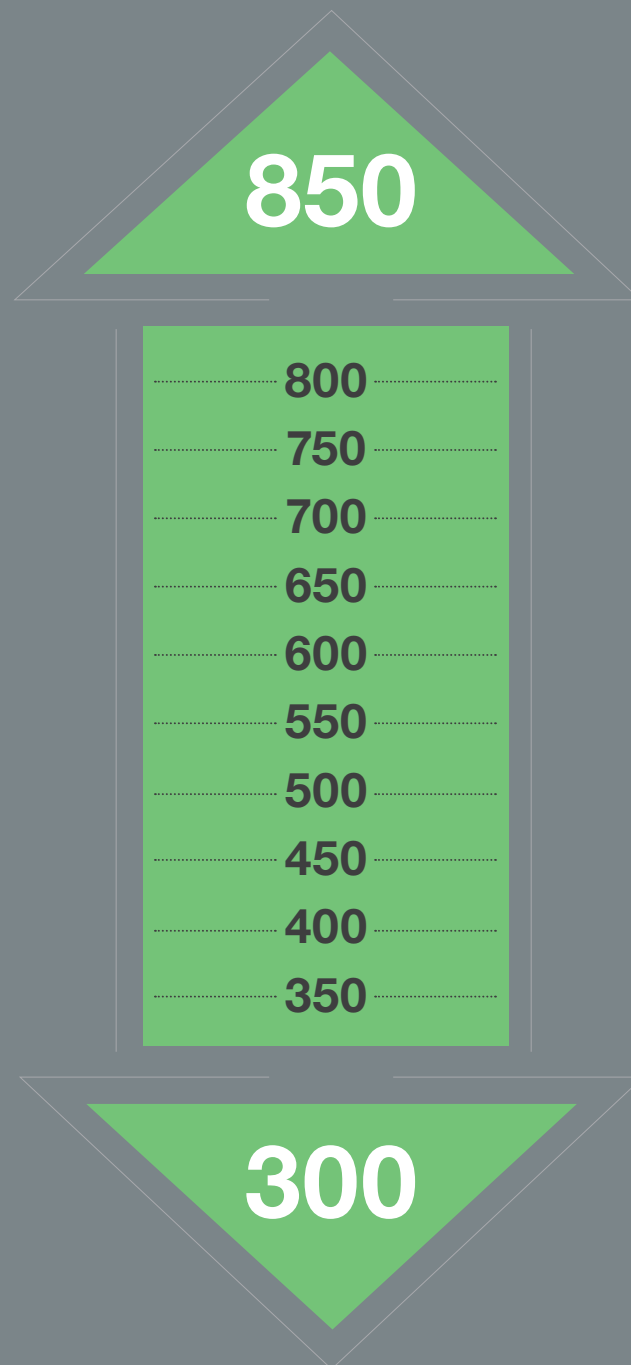
HOW IS A CREDIT SCORE MEASURED?

The credit report is summarized by a three-digit number — the credit score — to give banks and other businesses a quick snapshot regarding your reputation as a borrower. Credit scores traditionally range from 300 to 850. In general, scores above 700 are seen as good credit risks while scores below 660 may indicate credit problems.

IMPORTANT FACTORS:

- » Payment history — have you paid on time?
- » Length of credit history — how long have you been using credit?
- » Types and number of credit cards — how many accounts do you have open?
- » Amounts owed — what is your ratio of total debt to available credit?
- » New credit — Too many recently opened accounts or new inquiries could make you look riskier to potential lenders.

HIGHEST CREDIT SCORE



LOWEST CREDIT SCORE

GET YOUR FREE CREDIT REPORT

It's a good idea to review your credit report every year to get a snapshot of your own history; this is also a good way to check for any fraudulent activity or to identify and purge unneeded credit cards.

The three reporting agencies are Equifax, Experian and TransUnion. You can request a free annual credit report through a centralized service — the Annual Credit Report Request Service — at annualcreditreport.com or by calling (877) 322-8228. Or you can contact the specific agencies individually. For a small fee, you can also request your credit score.

There are three credit reporting agencies:
Equifax, Experian,
and TransUnion.



Equifax Inc. • Atlanta, GA • USA • www.equifax.com

www.equifax.com

(800) 685-1111



www.experian.com

(888) 397-3742



www.transunion.com

(800) 888-4213

THE COST OF BAD CREDIT

Simply put, people with worse credit reputations get charged higher interest rates when borrowing, and higher interest rates can cost you a lot of money. The example below illustrates the potential cost of bad credit by looking at two hypothetical home buyers each looking to take out a \$200,000 30-year mortgage. One borrower has good credit and the other not-so-good credit.

The good credit buyer gets a mortgage with a 4% interest rate but the not-so-good credit buyer – because lenders view them as riskier – gets a 6% rate. And though it might not seem like much of a difference, that 2% more costs the credit-challenged buyer a LOT of money, both in terms of the monthly payment and the total interest costs over the life of the loan.

GOOD CREDIT



720 CREDIT SCORE

\$200,000 LOAN

30 YEARS

4% APR

PAYMENT = \$955 PER MONTH

FINANCE CHARGE IS \$143,700

NOT-SO-GOOD CREDIT



620 CREDIT SCORE

\$200,000 LOAN

30 YEARS

6% APR

PAYMENT = \$1200 PER MONTH

FINANCE CHARGE IS \$231,700

IN THE EXAMPLE ABOVE THE DIFFERENCE IS \$88,000

Important: The interest rates illustrated above for the respective credit scores are simply an example and are not indicative of actual rates one may be offered given the assumed credit scores. Payments and finance charges have been rounded for illustrative purposes.

CREDIT REPAIR

THE CREDIT REPAIR ORGANIZATIONS ACT

Credit repair organizations often target consumers with poor credit histories, promising to clean up their credit report. Unfortunately though, there is no quick fix for creditworthiness and the tactics some of these organizations use are actually illegal.

The Credit Repair Organizations Act requires credit repair organizations to give you a copy of the “Consumer Credit File Rights Under State and Federal Law” before you sign a contract. They must also provide you a written contract that spells out your rights and obligations. Make sure you read and understand the contract before signing anything.

More information on this topic is available on The Consumer Financial Protection Bureau’s website ([CFPB.gov](https://www.consumerfinance.gov)) by searching “credit repair”.

EXERCISE CAUTION

Be cautious if a credit repair organization:

- » Asks you to pay for credit repair services before providing them.
- » Does not inform you of your rights and the steps you can take to help yourself at no cost.
- » Recommends you do not contact any of the three consumer reporting agencies directly.
- » Tells you they can remove most or all of the negative credit information in your credit report, even if that information is accurate and current.
- » Advises you to dispute all the information in your credit report, regardless of its accuracy or timeliness.
- » Suggests you create a new credit file by applying for credit using an Employer Identification Number (EIN) along with a new address, instead of your Social Security number (SSN). The use of your EIN for legitimate business purposes is legal; an attempt to defraud a creditor is punishable under federal and state law.



CAUTION

LOOK FOR RED FLAGS

Are you using credit responsibly? Take this test. Then take action if necessary.

	Yes	No
1. Are you borrowing to pay for items you once paid for with cash?	<input type="checkbox"/>	<input type="checkbox"/>
2. Is an increasing percentage of your income going to pay debts?	<input type="checkbox"/>	<input type="checkbox"/>
3. Are you paying bills with money reserved for something else?	<input type="checkbox"/>	<input type="checkbox"/>
4. Are you taking money from savings to pay current expenses?	<input type="checkbox"/>	<input type="checkbox"/>
5. Is your emergency fund (which should equal at least 3-6 months of basic living expenses) inadequate or nonexistent?	<input type="checkbox"/>	<input type="checkbox"/>
6. Do you pay only minimums on your revolving charge accounts?	<input type="checkbox"/>	<input type="checkbox"/>
7. Are you making payments in 60-90 days that you once made in 30?	<input type="checkbox"/>	<input type="checkbox"/>
8. Are you near or at the limit on your credit cards and other sources of borrowing?	<input type="checkbox"/>	<input type="checkbox"/>
9. Do you take out a new loan before an old one is paid in full or take out a new loan to pay an existing loan?	<input type="checkbox"/>	<input type="checkbox"/>
10. Do you take out payday loans?	<input type="checkbox"/>	<input type="checkbox"/>
11. Are you unsure about how much you owe?	<input type="checkbox"/>	<input type="checkbox"/>
12. Are you chronically late in paying your expenses?	<input type="checkbox"/>	<input type="checkbox"/>
13. Are you threatened with repossession of your vehicle, cancellation of your credit cards, or other legal action?	<input type="checkbox"/>	<input type="checkbox"/>

If You Answered:	You Are:	You Should:
"No" to all questions	Managing debt well.	Continue practicing good money management.
"Yes" to any question 1-5	Getting out of control.	Stop using credit until current debt balances are paid.
"Yes" to any question 6-11	On the verge of trouble.	Stop using credit. Develop a spending plan and debt payment plan.
"Yes" to question 12 or 13	Probably overextended.	Consult a financial planning professional now, before your financial goals become impossible to achieve.

NOTATIONS

ACCESS MORE FREE EDUCATIONAL MATERIALS TODAY

- ▶ Financial Planning and Goal Setting
- ▶ Building Your Savings
- ▶ Understanding Credit
- ▶ Managing Debt
- ▶ Buying or Renting a Home
- ▶ Buying a Vehicle
- ▶ Basic Investing
- ▶ Planning for Retirement
- ▶ Individual Retirement Accounts (IRAs)
- ▶ Financing College





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