

ABC's of Credit

It's not your money.
You're borrowing it.



MERIWEST
CREDIT UNION



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Credit – Let's Define It

- Credit
 - Trust given to another person for future payment of a loan, credit card balance, etc.
- Creditor
 - A person or company to whom a debt is owed



Types of Credit/Financing

- Revolving Credit
- Installment Credit



How do I get credit?

- Your first checking account is usually your first entry on your credit report.
- Get employed!
- Pay your bills on time
 - Cell phone
 - Gas and Electric
 - Cable



When should I use credit?

- To spread out long term buying costs
 - Pay a large lump sum or smaller payments over time
- Use for big important purchases
 - Cars
 - Homes
- Plan credit purchases carefully.



When should I not use credit?

- Don't use credit for regular everyday purchases
 - Pizza's/Meals
 - Movies
 - Concerts
 - What else?



What happens if I blow it?

- Bad credit can last at least 7 years.
- Collection accounts can be on your report for years if they are left unpaid
- Creditors and bill collectors will be calling you
- You will have to use check cashing stores and pay day lenders to get by.
 - What are the costs?



How to calculate simple interest...

The Credit Card Formula is:

Loan Amount x Rate (expressed as a decimal) / 365 days x No. of Days

Results in the Interest Due

Example Problem: Calculate the interest due on a \$4,000 credit card balance that starts on Nov. 1st and is paid off on Dec. 1st at the rate of 8%

$\$4,000 \times .08 / 365 \times 30 \text{ days} = \26.30

Installment loan credit is based on a 12 month year. The calculation is:

Loan Amount x rate (expressed as a decimal) / 12 months = Monthly Interest



Loan Example #1

Bill needs to fix his car. He borrows \$300 from his parents until he gets paid on the last day of October. Today is Oct. 10th. His parents will charge him 5% interest. How much will he owe his parents on Oct. 31st?



Solution to Example #1

$$\$300 \times .05 / 365 \times 21 \text{ days} = 86 \text{ cents}$$

Bill would owe his parents \$300.86



Loan Example #2

Brittany is getting an interest only installment loan of \$4,000 from her parents for college. The loan needs to be paid back at the rate of 11% when her grant/scholarship is paid to her. She will not receive her grant/scholarship until Dec. 1st. She needs to have the money for tuition on Sept. 1st so that is the first day of her loan.

Calculate how much interest Brittany will pay to her parents each month. What is the total amount Brittany is paying back?



Solution to Example #2

$$\$4,000 \times 11\% / 12 \text{ months} = \$36.66$$

$$\$36.66 \times 3 \text{ months} = \$109.98$$

Adding the interest on to the principal amount of \$4,000 results in

\$4,109.98



Amortization

Amortization comes from the French word for **death-Mort**. The idea of amortization is to pay a loan until it dies. This is the type of loans we generally receive for a car or a home. It is also commonly called an installment loan.

Let's use an amortization factor to calculate a home's loan payment.

Then you need to calculate how much interest was paid for the life of the loan.



Loan Example #3

David is buying a home. He is going to get a 15 year loan from the bank for \$250,000 at 5.50% to help him with the purchase.

David's amortization factor for a 15 year loan at 5.50% is .00817083.

We want to know:

How much is David's monthly payment?

How many monthly payments will David make?

What is the total amount of all his payments?

How much of his total payments went to interest?



Solution to Loan Example #3

How much is David's monthly payment?

$$\$250,000 \times .00817083 = \$2,042.71$$

How many monthly payments will David make?

$$15 \text{ years} \times 12 \text{ months} = 180$$

What is the total amount of all his payments?

$$180 \times \$2,042.71 = \$367,687.80$$

How much of his total payments went to interest?

$$\$367,687.80 - \$250,000 = \$117,687.80 \text{ in interest paid for 15 years}$$



Good Credit vs. Bad Credit

- 35% of your credit score is based on your payment history.
 - One late payment can set you back 100+ points on your score
 - One late payment can cause your Credit Card's interest rates to increase
 - Poor credit scores will result in increased borrowing costs the next time you apply
 - Or no credit at all!



Credit Scores Continued

- 30% of your credit score is based on the credit balances you maintain
- 25% is the types of credit you maintain
- 10% is based on the number of credit inquiries made on your report.



Good Credit vs. Bad Credit

As we know, someone with a poor credit history will pay more when borrowing. Let's see how much the difference might be on a car loan of \$8,000 for five years.

- Mr. Good Risk gets his loan at 5.50%. His payment is \$152.81.
 - How much total interest does Mr. Good Risk pay?
- Mr. Bad Money gets his loan at 10.50%. His payment is \$171.95
 - How much total interest does Mr. Bad Money pay?
 - How much more does Mr. Bad Money pay than Mr. Good Risk?