

Fact Sheet: Credit and Debt

Understanding Credit

From buying a pack of gum at the quick mart to financing a car, people use credit every day. Credit offers a way to get the things we need or want without having cash in hand. It allows us to buy things we might not be able to pay for all at once, like college or a house.

At the most basic level, credit is a promise that the money you borrow will eventually be repaid. The lender, who could be a company, bank, store, or credit card service or friend, usually charges interest for the use of the money.

Your Credit Report and Credit Score

Did you ever hear a teacher threaten to include your misbehavior on your "permanent record"? Your credit report doesn't keep track of detentions, but it does track information about you and your financial history. This information is also summarized into a number called your credit score, which is a three-digit number that's similar to SAT scores – credit scores range between 300 and 850, with around 680 being average.

Lenders, banks, colleges, insurance companies, credit card companies, landlords, and even employers have access to your credit report. Job applicants may even be turned down for a job because of a bad credit report.

"Building a Good Credit History" is really just another way of saying you building trust with people who lend money. A good credit history makes it possible to get more credit, especially for major purchases like a home, and keeps the cost of borrowing lower. Having to pay just one extra percentage point on an average home mortgage because of shaky credit could cost nearly \$75,000 dollars more in interest over the course of the loan.

To build and maintain good credit, follow these tips:

- Open a checking or savings account, and use it responsibly.
- Consider one (only one) credit card. Having more than one credit card will not help your credit score and may increase your risk of financial problems.
- Always make payments for loans and credit accounts by the due date each month.
- Often your education loan is the first loan you ever have. Handling repayment the right way establishes you as a responsible borrower.
- Review your credit report periodically for accuracy at AnnualCreditReport.com.
- Knowing what's on your credit report will give you a chance to dispute any inaccurate information.

If you have been denied credit, the lender is required under the Fair Credit Reporting Act to provide you with a free copy of your credit report. Otherwise, you can order a free copy up to once per year from link above.



Students and Credit Cards

Credit cards can be a major source of financial hardship for students and recent grads. The typical college student today graduates with nearly \$4,000 in credit card debt, in addition to about \$18,000 in student loan debt. According to some studies, 1 in 5 students graduate with over \$10,000 in credit card debt – and that's a monthly payment of over \$200 – just to pay the interest!

Credit cards can be used for sound and unsound reason. For example, using credit for a financial emergency like a car repair far away from home is a reasonable use of credit. But using credit cards when you're short on cash for dinners out, gadgets, and entertainment can be a dangerous game. As a general rule, if you can eat, drink or wear an item, it's usually not a good use of credit.

The Minimum Payment Trap

Credit cards are simple, right? You charge stuff and pay it off – what's so complicated about that? Besides the fact that you can quickly charge more than you could easily repay, credit card companies also charge interest and fees (the average late fee is now \$34).

Here's a good example of how interest works. Say you've charged a total of \$2,000 and then stop making new charges. If your card has a typical interest rate of 19% and a typical minimum repayment policy of 2% of your balance per month, it will take you more than 22 years to pay off the card and the total cost will be \$7,000 – if you make just the minimum payment.

How is that possible? Even though you pay off 2% per month, the amount you owe grows every day because of interest – your 2% mainly pays the interest and a fraction of the original \$2,000.

If it's not possible to pay off your entire balance each month, pay as much as you can. Most debt counselors recommend paying at least twice the minimum payment. That way, you will pay off part of the debt, not just interest.

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