



Using Credit, Reading Credit Reports, Interpreting Credit Scores and Reducing Debt



Using Credit, Reading Credit Reports, Interpreting Credit Scores and Reducing Debt

This session will focus on providing you with both information about this topic as well as new ideas and activities for making the training engaging. Specifically, during this session you will be:

- Understanding credit—definition and the products/services available
- Understanding how credit decisions are made
- Differentiating the quality and cost of credit
- Reading a credit report
- Improving credit history
- Understanding credit scores
- Improving credit score
- Disputing and correcting credit information

Is “credit” an important topic to address in financial education for AFI Participants?

YES NO

What are some reasons for or against including it:



An Overview of Credit

➤ *What is credit?*

➤ *What is debt?*

Problems with Credit

Write down all of the reasons you think people get into trouble with credit in the space below.

There are many times you may have used credit. The best times to use credit are for items that:

- Have long-term value; and,
- Are likely to increase in value.

Examples of things that have long-term value and are likely to increase in value are:

- A home;
- An education that will lead to skills and a higher paying job; and,
- A small business.

Try not to use credit for things that will be used up quickly or really have no value.

This is a list of things that are used up quickly or really have no value:

- Food
- Clothing
- Rent



- Household furnishings
- Automobiles

Credit and Emergencies

Sometimes you may not have the money to buy the things you want or need. Using credit to buy them should be a last resort. This is because paying off credit may take months or years. You tie up future earning to pay off that debt. And it costs you—in interest and fees.

Sometimes emergencies happen.

What are examples of emergencies people often cover with credit?

Planning for emergencies can help you avoid the use of credit. Thinking about other resources you might use to take care of emergencies before they happen can help you avoid credit, too.

Go back to the list above and think about ways you would cover some of these emergencies with resources other than credit.

How Credit Works

It can seem like such a good deal – buy something you want today and do not pay for it for months or years. Often, we end up paying more than double the cost of the item when we use credit. This is because of interest.



Interest is the fee you pay for borrowing the money.

Once you start to carry a balance, you start paying interest on the interest. This is compound interest. In the case of credit, compound interest works against you. When you save and invest, compound interest works for you. Most types of credit make you pay interest on the money you borrow. The interest that builds up on the unpaid balance is added to the total amount you owe each month. Next month, interest is figured out again and added to last month's balance. This continues for as long as you owe the money.

Here is an example using a credit card:

Ana opens a credit card with a \$1000 maximum. She pays an Annual Percentage Rate of 30%. This means that interest will compound at 2.5% monthly. Ana charges \$600 worth of gifts on her credit card in January. Each month she is charged 2.5% interest on her balance. The extra interest is added to last month's balance. Ana will pay the minimum payment of 2% of her balance each month.

Look at how compounding interest increases her balance each month on the spreadsheet.



Individual Exercise

➤ ***How many months will it take Ana to pay off the debt?***

➤ ***How much interest will she pay on the \$600?***



➤ ***What percentage of the total loan does she pay in interest by the end?***

[Note: Many of the major credit cards companies have increased the minimum balance payment from 2% to 4%. Look at the other side of the spreadsheet to see the difference 2% can make!]

Credit cards can be confusing because the companies use different ways to figure out how much interest to charge. [See the additional handout.] Most companies use an average daily balance method. The average balance on the card for each day is added up then divided by the number of days in the month. This gives the average daily balance. This amount is multiplied by the monthly periodic rate — the Annual Percentage Rate divided by 12. This gives the interest or finance charge for the month.

Credit, however, is necessary for many things:

- Homes
- Education and Training
- Businesses

Loans for businesses, homes and cars are installment loans. This means you pay an installment toward the balance of the loan every month. The amount you owe each month stays the same (unless you have a loan with a variable rate).

➤ ***What is a variable rate? vs. a fixed rate?***



Individual Exercise

See handout for example of an installment loan.

- ***What is the advantage of this kind of loan over a revolving loan (credit card, payday, etc.)?***

- ***How much interest will she pay on this loan?***

- ***What percentage of the total loan does she pay in interest by the end?***



The Credit Card Accountability, Responsibility and Disclosure Act

The purpose of these reforms is to eliminate predatory practices in the credit industry. Most of these changes are scheduled to be in effect starting February, 2010.

Summary of Some of the Major Changes:

1. **Forty-five day advance notice of changes to interest rates.** The current notice period is 15-days.
2. **Elimination of double cycle billing.** This method uses the average daily balance of the current *and previous* billing cycles. This is the most expensive way to calculate finance charges.
3. **No interest rate changes during first 12 months after opening a credit card unless the increase was disclosed when a person first opens the credit card.**
4. **No interest rate increases on pre-existing balances.** If a credit card company decides to increase the rate, the new rate would apply to new amounts charged on the credit card only. The balance prior to the rate increase would continue to accrue finance charges at the old rate.
5. **Penalty interest rate changes.** If an individual doesn't make a payment within 60 days of the due date even during the first 12 months of having the account open, he or she is subject to a penalty rate increase. If the rate is raised because the account was 60 days late, it must be returned to the previous rate following 6 months of on-time payments.
6. **Promotional APRs must be at least 6 months long unless the Federal Reserve identifies exceptions.**
7. **Over the limit fees cannot be applied unless an individual has "opted-in" to allow banks to process transactions that would take the individual over his/her credit limit.** Only one over the limit fee can be applied during a billing cycle.
8. **Payment above the minimum must go to the balance with the highest rate of interest** (as per changes to the rules outlined in #3 above).
9. **Credit card bills must be sent 21 days before the due date.** This gives consumers more time to pay their bills thereby reducing the potential for late fees and penalty interest rates being implemented.
10. **Credit card payments received by 5 p.m. on the date due are on time.** Currently, credit card companies may consider anything after 11 a.m. late even if their mail typically arrives in the afternoon. Payments are also on time if received the next business day if the due date falls on a weekend or holiday.



11. **Simplification of credit card disclosures.** Credit card issuers are now required to disclose the duration of penalty interest rates, simplify information about variable rates, detail when grace periods do/do not apply and use tables, bullet point lists and bold-faced type to make the information more accessible to the average consumer.
12. **Disclosures in billing statements.** Billing statements must be easier to understand and will have to include:
 - Year-to-date totals of interest and fees
 - Interest charged by the type of transaction
 - Information about the APR being used
 - The effect of minimum-only payments including total repayment time, i.e., “If you continue to make the minimum payment of \$_____ on the existing balance of \$_____ at the effective rate of _____% it will take you _____ months to repay your debt.”
13. **People under 21 can only open credit cards if:**
 - there is a co-signer over 21
 - the consumer submits financial information showing that he/she has the capacity to pay independently (he/she has sufficient income)Increases in the credit limits must include authorization from co-signer.
14. **Credit card issuers must consider a person’s ability to pay when issuing credit cards or increasing credit limits.**
15. **Limits prescreened offers to young people and requires transparency/disclosure of affinity arrangements between universities and credit card issuers.**



It is tough to get credit for these things if you have had trouble with credit in the past. Understanding how credit decisions are made can help you make changes so that you can qualify for conventional credit in the future.

You are probably wondering how people make the decision to give someone credit. Many creditors look at three things:

- Capacity
- Collateral
- Character

Because they don't know you like you know a friend wanting to borrow something (or like a business person would have known customers in the past) they need to use other information to figure out if you will pay back the money.

Capacity



Do you have the resources to pay the money back? This is what capacity is all about. Creditors want to know how you will pay the money back. Creditors use the following information to decide:

Information	Where They Get It
Your income	From you on a credit application. <i>They may ask for proof. If this is the case, you need to give a paycheck stub.</i>
Your debt	From you on a credit application. From a credit bureau on your credit report.
Your assets	From you on a credit application.
Your debt to income ratio	The creditor calculates this using information from your credit application and your credit report.

Creditors want to ensure that you have both:

- income, and
- employment

to cover the amount you borrow.



Creditors also want to make sure you don't have too much debt already. If you have too much debt already, they risk you not paying them back.



Debt to Income Ratio

The debt to income ratio is important. It tells creditors how much *more* debt you can handle. You can use the debt to income ratio to keep your debt in check.

The debt to income ratio is:

Your monthly debt payments divided by your monthly income

Here's an example:

Monthly income = \$2578.00

Monthly debt payments = \$564.00

Debt to income ratio is calculated as follows:

564 divided by 2578 = .22 or 22%

What does this mean?

For every \$1.00 earned, \$0.22 goes to pay debt.

Another way of saying it is that 22% of the income goes to cover existing debt.

If your debt to income ratio is:

- Less than 30%: Good!
- 30% to 36%: O.K... You won't have any problem with lenders, but work to bring it down below 30%.
- 36% to 40%: Borderline. Some lenders will still give you a loan but you may struggle to make your payments.
- 40% or higher: Red flag. Your credit situation requires attention.



Small Group—Calculate Debt to Income

Patty has just graduated completed her associates degree in nursing.

She has already landed a full time job earning \$14 per hour. She works full time (160 hours per month); she is also likely to work 10 – 20 hours of overtime each month at time and a half. She is will be working at a hospital 21 miles from her home.

She found good used car, but he can't afford to buy it without a loan. Her monthly payments on that loan would be \$195.

Every month she also pays the following debts:

- **School loan \$123.00**
- **Credit card \$130.00**
- **Mortgage \$625.00**

What is the debt to income ratio? _____

Should she get the loan? _____

Capital and Collateral

Sometimes your ability to repay is just not enough. They want to know if you have other assets to “tap into” should your income stop. This is **capital**. Sometimes creditors want something they can have in case you don't pay them back. This is **collateral**. Many forms of credit like most credit cards do not need collateral.

Big loans for items like cars or homes usually do. The collateral is usually the item the loan is for. In the case of a loan for a car, the car becomes the collateral. The car is actually “pledged” (which is like a legal promise) against the loan should you not pay it. If you don't pay back the loan, they take it and sell it. This is called repossession or “repo” for short.

Character

Creditors care about character because they want to know if you will pay them back. And pay them back on time.



Creditors don't know you personally. So, they have to use something else to determine whether you are the “kind of person who honors his/her debts.”

What do you think they use? The answer is your credit report. A credit report is a written record of some of your bill paying history. Based on this history of **some of your bill paying history**, creditors determine your character.



Something to Think About: Character = Credit Report

Is a record of someone's bill paying history a good record of their character?

YES NO

If yes, why do you a credit report is a good way to measure someone's character.

If no, why don't you think a credit report is a good way to measure someone's character?

Credit Reports

A credit report is a collection of **some of your bill paying history**. It shows many things including:

- Credit cards you have
- Loans you have
- The amount of money you have borrowed through loans and credit cards
- On-time payments for credit cards and loans
- Late payments
- A history of the places you have lived
- Whether you have any payments outstanding because of legal judgments
- And more

How Long Does Negative Information Stay On?

In general, negative information stays on your credit report for seven years except in the following cases:

- Bankruptcies are reported for 10 years.
- Tax liens are reported until you pay them off and THEN for seven more years.
- Civil lawsuits, judgments and arrests will stay on your credit history for seven years after they are recorded by the court.

There are no time limits for the reporting of negative credit record information when you:

- apply for a job with a yearly salary of \$75,000 or more.
- apply for more than \$150,000 worth of credit.
- apply for life insurance with a face value of \$150,000 or more.

But, not all of your bill paying is recorded. Many companies only report to the credit reporting agencies or credit bureaus if you miss a payment, are late or are delinquent. In other words, they only report negative information NOT positive information.

Why is it important for you to know about credit reports? A lot of people use credit reports to make decision about you.

- A bank will use it to decide whether to give you a loan.
- A credit card company will use it to decide whether to give you a credit card.



- A landlord may use it to determine whether to rent an apartment to you.
- A potential employer may use it to determine whether you will get a job.
- An insurance company may use it to determine whether to give you insurance coverage and the rates you will pay for coverage.

 **Many important decisions about you are tied to the credit report. This is the reason it's important to know about and understand credit reports.**

Who Makes Credit Reports?

You know credit reports exist, but you may be wondering who makes them. Credit reports are made by credit reporting agencies (sometimes they are called credit bureaus). The three main credit reporting agencies are”

- Experian
- Equifax
- Transunion

Equifax PO Box 740241 Atlanta, GA 30374-0241 1-800-685-1111 www.equifax.com	Transunion PO Box 1000 Chester, PA 19022 1-800-916-8800 www.transunion.com	Experian PO Box 2002 Allen, TX 75013 1-888-397-3742 www.experian.com
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You can order a credit report from any of these companies any time. You can get one free report each year from all three credit reporting agencies. After you receive one free report, there is usually a fee for any additional reports in a year unless:

- You have been denied credit, a job or an apartment based on your credit—then you get a free report from the credit bureau that gave the information that led to your denial.
- You are receiving public assistance—then you are allowed an additional free report.

A great place to start is getting your free report. There are three options.

Option 1	Go to www.annualcreditreport.com Be sure to go to this site. There are many sites that claim to be the site for “the annual credit report.” These other sites always end up charging you.
Option 2	Call 1-877-322-8228
Option 3	Write to: Annual Credit Report Request Service P.O. Box 105281 Atlanta, GA 30348-5281 Many people find this option the easiest to use AND understand.



Credit Reporting Agencies keep information on millions on people. To get yours, you will need to give them:

- Name
- Address (and your previous two or three most recent addresses)
- Birth date
- Social Security Number

How does information get on your credit report?

Individuals and businesses report your payment patterns to credit bureaus. They report your payment patterns:

- When you make your payments on time
- When you are late with your payment
- If you miss a payment
- If you miss many payments — by this time, your debt may be in collections
- If you seem to have stopped paying altogether

Who Reports to the Credit Bureau?

Use the space below to make a list of the people that do and do not report things to credit bureaus.

Individuals or Businesses that REPORT to Credit Bureaus

Individuals or Businesses that DO NOT REPORT to Credit Bureaus

Some financial institutions will help you qualify for credit by helping you build a non-traditional credit history. They do this by looking at bills you have paid that do not appear on your credit report.



Reading a Credit Report⁴¹

Reading a credit report can be hard. If you have never seen a credit report, look at the box below. If you want to understand how to read your credit report, use the information found on the credit report itself. Remember, there are three major credit bureaus. Each one has its own way to show problems with your credit.

In general, each credit report will contain the following sections:

- **Personal identification information** — This includes your name, current address, date of birth, social security number, previous addresses, and employment history.
- **Public record information** — For example, if you have filed for bankruptcy; if there are any liens, judgments, garnishments, or foreclosures against you; your marital status; whether you are participating in financial counseling.
- **Collection agency account information** — This section will show if you have any accounts with a collection agency and the status of your accounts.
- **Credit account information** — This section will show any accounts you have now or that you had before with creditors. This includes the company name, account number, date opened, last activity, type of account and status, highest credit amount, items as of date (any amount currently owed and whether you are current or late with payments) and the terms and balance, whether you have a past due bill, and the date reported to the credit bureau
- **Inquiries made to your account** — Companies look at your credit report when you apply for credit, reviews your account, or offers you a special promotion. Promotional inquiries, periodic reviews of your credit history by one of your creditors, and your requests for a copy of your report are not reported.

Sidebar: I Have Never Had Credit! How Do I Get It?

Not to worry! Everyone starts out with no credit history and builds it over time. There are many ways to get started:

First: Get a secured credit card.

This is a credit card where the credit limit on the card is the same as the amount of money that you have placed in an account that is dedicated to pay the debts on the card if you do not. There is little risk for the creditor here. They have your money as security to cover the debt. And you get the chance to show that you can pay on time.

Second: Use a local financial institution.

Often, local institutions, especially credit unions, will have credit products that you can get without a formal history. In this case, your history of payment on utilities and phone bills can serve as alternative proof of your payment behavior.

Remember that the key to building a credit history is to start with just one account. Use the account to buy a few things that you can afford. Then pay it back each month, on time. Pay at least the minimum balance if not more, too.

⁴¹ Source: www.creditinfocenter.com/creditreports/decoderp.shtml



Small Group Work--Reading a Credit Report

Use the following questions to read the credit report you and your team receives.

1. Whose credit report is this?
2. Where does the person live?
3. How many places has the person lived?
4. Has the person had a bankruptcy?
5. Has the person had a lien?
6. Has the person had an account in collections? If yes, what is the account?
7. How many credit accounts does this person have open?
8. What is the balance on each account?
9. How many are late?
10. Overall, do you think this person's credit looks good or does it look like it needs work?
11. Would you extend more credit to them? Why or why not?



Repairing Credit⁴²

If you have problems on your credit report, you may decide you want to fix them. If you do not fix them, you may not be able to get credit. Or, the credit you can get will be very expensive. Here are some steps to take in **repairing your credit**:

1. **Order and review your credit report.** Get help in reviewing your credit report if you have never done it before. Use the worksheet in the resources section of this handout.
2. **Identify any mistakes.** Take immediate action to correct those mistakes. Use the worksheet in the resources section of this handout to help you write letters of dispute.
3. **If you have any payments that are late, get current.** And make sure you stay current.
4. **If you have any outstanding judgments, use your budget to find ways to pay those off.**
5. **If you have balances on credit cards, use the following list to help prioritize those to pay down first.**
 - **Highest rates of interest—these are costing you more**
 - **Call your creditors to try to negotiate a lower rate if:**
 - You have paid them regularly
 - You have seen a lower rate advertised by them for new customer
 - **Where you have used 30% or more of your available credit**
6. **Go over credit cards you have with no balances (charge cards, credit cards, etc.).** If there are any you haven't used in a while, consider using them or closing them. Inactive credit accounts run the risk of being closed by the credit card issuer—it looks

⁴² From workshop series *Financial Health Increases Your Wealth*. Developed by Inger Giuffrida for Citizen Potawatomi Nation. Please cite when using. Thanks!



better on your credit history if the account is closed by your request rather than vice versa.

7. If you do have access to more credit than you think you should, close some of the accounts. If you choose to close some accounts, **be sure to close those accounts that you have had the shortest period of time.**
8. **Send a letter to the card issuer asking them to close those accounts you identify in the above step.** Make sure you say **effective immediately** and cut up the card.
9. **Develop a plan to pay debt in collections or old debts.**
 - **Be aware of your rights when collectors are trying to collect money from you.**
 - Contact creditors that you did not pay in the past using the information on your credit report. Sometimes this means contacting a collection agency.
 - See if the company will work with you. They may be able to help you get back on track.
 - Once you have paid off an old debt or something in collection, order a credit report. Check to make sure the payments you made are on the report.

Avoid any business or any person that claims they can fix your credit. It is not true.

No one can remove negative information from you credit report if the information is true. You can improve your credit history and your reputation with creditors only through regular monthly payments.

Remember, you can get help from:

- **A local non profit organization**
- **Consumer Credit Counseling Services**
- **A local bank**
- **A local credit union**



Credit Building Tools You Can Use

Credit Report Review Checklist

Credit reporting agencies (credit bureaus) **often** make mistakes in reporting your credit information. It is important to review your credit report at least once a year to make sure the information is right. You may be denied:

- a credit card
- a lease on an apartment
- insurance coverage or
- a job

if there is negative information on your credit report. You need to ensure there are no errors.

After your credit report comes to you, complete this form and keep it with your credit report in a safe place. If you need to write a letter to the credit bureau to correct something on your report, keep a copy with this form as well.

Today's Date: _____ Name of Credit Bureau _____

_____ Read through your entire credit report.

_____ Is your name correct?

_____ Is your social security number correct?

_____ Is your current address correct?

_____ Are the previous addresses they have listed for you correct?

_____ Is there anything listed in the public record information? Is it correct? Highlight the information you think may **not** be correct.

_____ Is there anything listed in the collection agency account information? Is it correct? Highlight the information you think may **not** be correct.

_____ Review each item under the credit account information. Do you have these accounts reported open? Did you once have the accounts reported closed?



_____ Are all of the balances correct?

_____ Is negative information reported on each credit account information correct? Look for late payments and missed payments. Highlight those items you think are incorrect.

Tool #2: Dispute Letter Checklist and Example Letter

If there are any items that are not correct, you have both the **right AND responsibility** to get these items corrected. Use the following checklist as well as the example letter that follows to dispute any entries on your credit report you think are incorrect.

_____ Write a letter to the credit bureau that sent you the report.

_____ Provide the account number for the item you feel is not accurate.

_____ For each item, explain concisely why you believe it is not accurate.

_____ If you can, include copies of bills or loans that show you have paid them on time.

_____ Provide your address and telephone number at the end of the letter so the credit bureau can contact you for more information if necessary.

_____ Make a copy of your letter before you send it to the credit bureau.

_____ Once you mail your letter to the credit bureau, follow up in 30 days if you have not heard anything. Be sure to have a copy of your letter in front of you so you can talk about the items you are disputing. Be prepared to write another letter to the credit bureau, if you have to.



Example Dispute Resolution Letter from the Federal Trade Commission

Date
Your Name
Your Address

Name of Credit Reporting Agency
Address

Dear Sir or Madam:

I am writing to dispute the following information in my file. I have circled the items I dispute the attached copy of the report I received on ___/___/___.

[Insert name of item and account or court case number] is inaccurate because [describe the reasons it is inaccurate]. I am requesting the item be removed [or adjusted, etc.] to correct information.

Enclosed are copies of [insert list of support documentation that helps prove your claim; O INCLUDE COPIES—NEVER SEND ORIGINALS] supporting my position.

Please investigate this matter and delete [correct] the dispute item(s) as soon as possible.

Sincerely,
Your name

Enclosures: List of what you are enclosing



Tool #3: Debt Management Worksheet

You can use the following worksheet to ensure you know exactly how much debt you have. Then you can use this as the basis for creating a debt management strategy. :

- Credit card statements;
- Loan agreements and payment coupon books; and
- Bills from charge card companies.

For old debts, participants may need to refer to their credit reports to complete this worksheet.

Credit Card or Charge Card # and Creditor	Date Opened	Credit Limit	APR and Fees	Amount Owed	Due Date	Minimum Payment/ Amount Due	Fixed Payment Above Minimum I Can Afford

Loans # and Creditor	Date Originated	Amount Borrowed	APR and Fees	Amount Due Monthly	Due Date	Amount Over Payment to Reduce Principal	Other loans terms including rate adjustments or balloon payments

Old Debt/ Collect Accounts # and Creditor	Date Charged Off	Amount Due	Collection Agency Information	Amount Required to Fulfill Obligation	Notes



Debt Consolidation⁴³

Debt consolidation must be approached with caution. Here are some of the pros and cons of debt consolidation:

Pros	Cons
<p>One payment instead of lots of payments which may be easier to manage.</p> <p>Generally a reduction in interest rates especially if done through a home equity loan. If you have poor credit, however, you're likely to pay a fairly high rate. The rate will be even higher if the loan is unsecured.</p> <p>Lower monthly payments.</p> <p>Only one creditor to deal with.</p> <p>Tax deduction on interest if debt consolidation is based on home equity (a second mortgage).</p>	<p>Easy to get further in debt (70% of Americans end up with the same or higher debt within 2 years of taking the debt consolidation loan)—once people have a lighter load on a monthly basis, they tend to increase spending; often people find themselves deeper in debt with a debt consolidation loan because the underlying behaviors have not changed.</p> <p>While monthly payments are lower, people end up paying for a lot longer time—the lower payment is the result of stretching out the terms.</p> <p>This means that over the long-term the debt actually costs more; it's just more manageable in the short-term.</p> <p>Many debt consolidation loans are secured—this puts whatever is used to secure the loan (including a home) at risk of being repossessed in case of default—you can lose whatever you secure the loan with.</p>

Here are questions to have answered before taking out a debt consolidation loan:

1. How difficult is it for you to make monthly debt payments now? (Have you tried budgeting approaches already?)
2. Would the new loan (the debt consolidation loan) rate be lower than your current weighted average rate (see next page-Calculating the Weighted Average Interest Rate)?
3. Is the interest rate fixed or can it be increased? (You want fixed; this is very important to understand.)
4. Are there monthly fees, enrollment fees or penalties including prepayment penalties?

⁴³ From workshop series *Financial Health Increases Your Wealth*. Developed by Inger Giuffrida for Citizen Potawatomi Nation. Please cite when using. Thanks!



5. What are some of the risks involved? Could you lose your home as a result of this loan?
6. Are you working with a reputable lender? While this may be hard to determine, there are a lot of businesses that offer these loans and many do not have long track records or may be predatory lenders. Be careful—get assistance.

Finally, some experts suggest setting up a Debt Management Plan (DMP) with a Credit Counseling (use a nonprofit). This also results in one payment, but comes with credit counseling and a commitment not to use credit. Because credit counseling agencies often negotiate lower payouts to creditors, DMPs can reflect negatively on your credit history.

Calculating the Weighted Average Interest Rate

Step 1

Multiply each loan by its interest rate to obtain the *per loan weight factor*.

$$\$20,000 * 6.543\% = 1308.6$$

$$\$10,000 * 7.943\% = 794.3$$

Step 2

Add the per loan weight factors together.

$$1308.6 + 794.3 = 2102.9$$

Step 3

Add the loan amounts together.

$$\$20,000 + \$10,000 = \$30,000$$

Step 4

Divide the *total per loan weight factor* by the total loan amount and then multiply by 100. This will give you the actual interest rate.

$$2102.9 / \$30,000 = 7.0097\%$$

Step 5

Then round to the next nearest 1/8%.

$$7.0097\% \text{ to the nearest } 1/8\% = 7.01\%$$

You would want your estimated consolidation interest rate to be equal to or less than 7.01%.

Credit Scores⁴⁴

Credit scores sum up key pieces of your credit history (from the report) in a number. Generally, the higher the number the better your credit score—this means you are likely to get credit and at more affordable rates.

Credit scores come from math formulas that the companies that make credit scores use weighting specific factors on your credit reports. Thus, your credit scores come from your credit reports.

Creditors use the score to decide whether to give you credit. They also use it to decide how much credit to give you—this is the amount of your loan and how much to charge you for the credit—this is the interest rate and fees they will charge you. If you need to improve your credit scores, creditors may still give you credit. They often increase the cost of credit, however. Your interest rate and fees might be higher.

FICO Scores

While there are many companies including the three large credit bureaus that produce credit scores for consumers, the credit scores produced by Fair Isaac Corporation—FICO Scores—are the most commonly used.

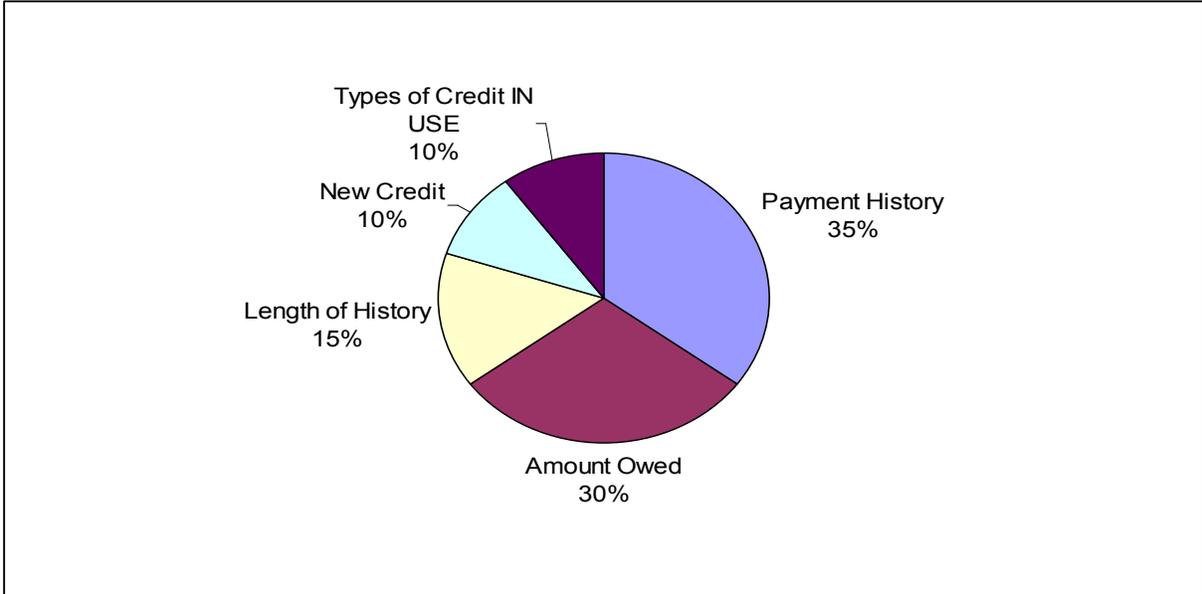


⁴⁴ From workshop series *Financial Health Increases Your Wealth*. Developed by Inger Giuffrida for Citizen Potawatomi Nation. Please cite when using. Thanks!



Here is what FICO, the leading producer of credit scores, uses to create your score. This information comes from your credit report.

Name on Chart	What It Means	The Questions Creditors Ask
Payment History (35% of the total credit score)	Your track record with paying back your debts.	<input type="checkbox"/> Have you paid on time? <input type="checkbox"/> How often do you pay late? <input type="checkbox"/> By how much?
Amounts Owed (30% of the score)	The debts you owe right now	<input type="checkbox"/> On all your credit sources, how much debt are you carrying? <input type="checkbox"/> What is your credit utilization rate?
Length of Credit History (15% of score)	Your "credit age"	<input type="checkbox"/> How long have you had credit?
New Credit (10% of score)	A clue to see if you are stretched too thin and using lots of credit to catch up	<input type="checkbox"/> Have you opened any new credit lines recently? <input type="checkbox"/> What kind and for how much?
Types of credit used (10% of score)	Your line up of revolving, installment and other forms of credit	<input type="checkbox"/> How many credit or department store charge cards do you have? <input type="checkbox"/> How many auto loans? <input type="checkbox"/> Do you have any mortgages or student loans?



Increasingly, lenders and others are relying on your credit score alone. It is possible to improve your score.

Improving the Credit Score

Based on the information that is used to calculate a credit score, what are five things a person can do to increase his/her credit score.



Strategies for Improving Your Credit Score

1. Order and review your credit reports. Dispute any errors. Be sure to look for items that should have dropped off due to the limits for reporting negative information.
2. Order your credit score. Visit www.myfico.com to get your FICO score. In order to improve something, you need to know where you are starting,
3. Pay all bills on time—this will have the biggest impact since 35% of your score is comprised of your bill paying track record.
4. If you have missed payments, get current and stay current.
5. Pay down debt balances—this lowers the amount of credit you are using vs. how much you have available. Some people advise never going over 30% of your credit limits on credit cards or lines of credit.
6. If you need to close some credit accounts, close those with the shortest history (the newer accounts) first. Don't close too many accounts, however, as this increases your debt to available credit ratio.
7. Use all of your credit account/cards. A dormant account does not help your credit score very much. Just be sure to pay them on time and pay them off in full according to the terms of the credit.
8. Don't open a number of new credit cards just to increase the amount of available credit.
9. If you are late on an account you are always on time with, call and see if they will remove this information from your records. This is called a goodwill adjustment.
10. If something seems incorrect—a late payment for example—you can dispute it. While an item is in dispute, it will not factor into your credit score.



Applying This Topic to Your Target Audience

Which sections of material covered in the credit session would be most relevant to the people you serve?

What would you cut out? Why?

What was missing for the people you serve?

The most valuable part of this session was:

What new ideas will you incorporate into your financial education training?

What additional information about or ideas for facilitating credit would be most helpful to you?
