

Using Credit Wisely



If used carefully, credit can be a helpful financial tool. For example, using credit to purchase a home now, rather than trying to save up the whole purchase price, makes financial sense. Credit may also help you deal promptly with costly emergencies. Many consumers turn to credit when faced with unexpected home or auto repairs, as well as medical emergencies. And credit offers convenience, enabling you to rent a car or hotel room or buy airline tickets over the phone. In many situations, credit offers peace of mind; there is no need to carry large amounts of cash when shopping or traveling.



BALANCE
Financially Empowering You

Despite all the advantages and conveniences credit can provide, there are some pitfalls associated with credit use. Credit can be expensive. Interest rates, finance charges, annual fees, and penalties can dramatically increase the cost of any purchase made on credit. Then, there is a tendency to overspend on credit. It is much easier to spend more than you can afford when all you have to do is pull out the plastic.

How Much Debt is OK?

As a rule, no more than 15% of your net (take home) income should be committed to unsecured debt payments each month. Another way to determine how much debt is appropriate for you to carry is to first complete a family budget. The amount remaining after you deduct your monthly savings and living expenses from your net income is the most you should have going to debt repayment.

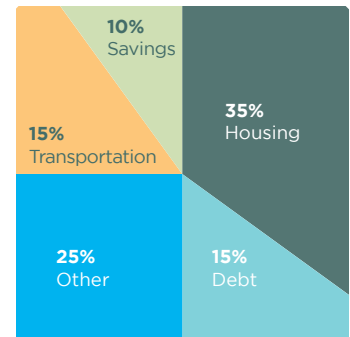
Housing - Spend no more than 35% of net income on housing. Depending on whether you rent or own, that can include: mortgage/rent, utilities, insurance, taxes, and home maintenance.

Savings - Save at least 10% of income throughout your working life. Make sure you have 3-6 months' income in an emergency fund before you start saving for other goals.

Transportation - Spend no more than 15% of net income on transportation. That includes: car payment, auto insurance, tag or license, maintenance, gasoline, and parking.

Debt - Spend no more than 15% of net income on all other consumer debt: student loans, retail installment contracts, credit cards, personal loans, tax debts, and medical debts.

Other Expenses - Spend no more than 25% of net income on all other expenses: food, clothing, entertainment, childcare, medical expenses, tithing/charity, and vacations.



Behaviors that lead to high credit scores, according to credit scoring company FICO

- Make debt payments on time
- Keep balances low on revolving debts
- Limit number of open revolving accounts
- Keep existing revolving debt accounts open long-term
- Limit new applications for credit
- Diversify types of credit with both installment and revolving accounts.

Shopping For Credit

When shopping for a credit card, you should first decide how you plan to use it so you can compare features. If you will pay your credit card bill off every month, no or a low annual fee is important. If you usually carry a balance, look for the lowest interest rate. Shop for a grace period, the amount of time after your purchase during which finance charges are not assessed. Some financial institutions give you up to 30 "free" days, while other card issuers start assessing finance charges immediately upon purchase. In fact, interest starts accruing immediately on cash advances - there is no grace period and the interest rate is higher than that applied to regular purchases. Depending on your payment and credit use habits, you may also be affected by late and over limit fees.

If you have no credit or a bad credit history, you may be able to obtain a secured credit card. A secured card works just like a regular VISA® or MasterCard® except that you must leave a deposit, usually between \$250 and \$500, with the issuing financial institution. If you default on your payments, the financial institution takes the money owed out of your deposit. The interest rate and annual fee on a secured card are often a bit higher than on a regular card. But a secured card can offer you the convenience of a regular credit card and the opportunity to improve your credit record. When comparing cards, try to find one that does not charge an application fee and confirm with the issuer that they will report your payment performance to at least one of the three major credit reporting bureaus. Make the most of this chance to build an unblemished credit report.

Ways to use credit as a goal achievement tool

- Having a strong credit standing can open up new financial opportunities previously unavailable to you, like buying a car or a home.
- Credit can be used to help cover expenses used to start your own business.
- A solid credit history can make it easier to gain employment or find a new place to live.
- Building a record of wise credit use will mean lower interest rates paid in the future, freeing up funds to use toward your dreams.
- If your goal is to get out of debt, you may be able to use a loan or another credit card to get a lower interest rate to repay the money.

The Cost of Credit

The following chart shows the cost of credit for a \$5,000 debt. At 18% interest, paying just the minimum monthly payment, it will take almost eight years to pay off the balance and will cost almost twice the amount of the original debt.

Paying only \$50 more a month takes four years off the repayment period and saves you thousands. Borrowing money at a lower interest rate cuts your costs even if you only pay the minimum due, but again, paying just \$50 more than the monthly minimum cuts the repayment time by three years and saves you another \$1,387.

Balance	Interest rate	Monthly payment	Repayment time	Total cost
\$5,000	18%	\$100	7 years, 10 months	\$9,311
\$5,000	18%	\$150	3 years, 11 months	\$6,984
\$5,000	15%	\$100	6 years, 6 months	\$7,896
\$5,000	15%	\$150	3 years, 8 months	\$6,509

Making use of lower interest credit to payoff high interest bills may be helpful in getting out of debt. Many creditors are offering low “teaser” rates to attract business.

- Most of these cards offer a low interest rate for a short time only, usually three months to a year.
- Know when your interest rate will increase and what the card’s regular interest rate is. It could be higher than the rate on your old card.
- Be sure the limit on the new card is high enough so that your entire balance can be transferred.
- Make sure that the interest rate applies to balance transfers, not just new purchases.
- Pay attention to the balance transfer fee. Even if the interest rate is low, you may not save money if the fee is high.

If You Are Unable to Pay

If you are unable to make the minimum payments on your bills, do not avoid your creditors. Be proactive. Write a letter asking for their understanding of your situation (see the sample letter on page 4). The creditor may offer a hardship program, allowing you to make reduced payments temporarily, and maybe even offer a reduced interest rate. It is best to contact your creditors in writing. Your letter should include:

- The reason you are unable to make your full payment (layoff, injury, divorce, etc.)
- Your prospects for getting back on track (When do you expect to start a new job? When does your doctor say you’ll be able to return to work?)
- What you are proposing (Suggest to the creditor what you think is a reasonable amount to pay each month until you are able to resume full payments.)

When writing to your creditors, be realistic. Don’t ever promise to send a payment that you are not absolutely sure you will be able to afford. Your creditors will be more willing to work with you if you are straightforward with them. Keep a copy of each letter you send.

Caution: Be conscious of the total amount you are promising to creditors each month; \$30 might not seem like much, but if you have eight credit cards and make the same promise to all of them, you will be out \$240 that might be needed for rent or food.

10 Warning signs of credit trouble

1. Paying only the minimum on your credit cards
2. Charging more each month than you pay
3. Using credit for items that used to be purchased with cash
4. Having a total credit balance that rarely decreases
5. Being near your credit limit and applying for new cards
6. Needing a consolidation loan to pay existing debt
7. Not knowing the total amount you owe
8. Feeling stress about your finances
9. Draining your savings to pay debts
10. Making bill payments late

Sample letter to a creditor

Dear Creditor:

Due to a layoff, I am temporarily unemployed and, as a result, am experiencing financial difficulties. I have analyzed my current situation (with the help of BALANCE, if applicable).

After making a strict budget for my expenses, I find it necessary that I ask each creditor to accept a reduced payment for the next three months. By then, I expect to be back at work full-time.

I would appreciate your cooperation in making this payment plan work. In place of the regular payment of \$80, I request that you accept payments of \$30 per month during this emergency. I will pay before the 30th of the month.

You can be sure that I will resume normal payments as soon as possible. Thank you for your consideration. If there are any changes in my situation, I will notify you of them as soon as possible.

Sincerely,

Name

Address

Account Number



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