

Budgeting, living within your income and saving money are vital steps to wise money management. But sometimes you face an expense that is difficult (if not impossible) to pay for out of pocket. Many people who don't have the cash at such times turn to credit.

Credit is the opportunity to borrow money to use now and then repay over time at an agreed upon cost. Credit can be a convenience and an important financial tool if it's used wisely. By understanding how credit works, what it costs, and how to avoid accumulating too much debt, you can use credit to your advantage.

Types of credit

Installment credit, such as car loans or home mortgages, requires you to make a fixed number of monthly payments until the original loan amount is repaid in full.

Revolving credit, also known as short-term or open-ended credit, allows you to borrow money, up to an assigned credit limit, over and over again. The amount of your available credit shrinks as you use it and grows again as you repay the borrowed money. For example, if you had a \$1,000 credit limit and you used \$200, your available credit would be \$800. If you paid off the \$200 when your bill arrived, you would have access to the full \$1,000 again.

With revolving credit, you have the option to pay the entire outstanding balance when the bill is due or to pay a part of the balance and carry over the remainder to the following month. You will pay interest on the debt you carry over. Interest is the lender's fee for allowing you to use its money.

Examples of revolving credit include credit cards and lines of credit, such as overdraft protection for your checking account and a home equity line of credit (HELOC). Banks, credit unions, credit card companies, retailers, mortgage companies and others offer revolving credit accounts.

Your credit report

Your credit report is a detailed record of how you've paid your bills and managed your credit over the years. Lenders use your credit history to help them decide whether to grant you credit and, if so, what interest rate you will pay.

The better your credit history, the more likely it will be that your credit application will be approved and that you will qualify for the lowest (prime) interest rates.

Check your credit report regularly to catch any errors that could damage your record. By law, you can receive free copies annually by going online (www.annualcreditreport.com) or by calling 877-322-8228.

Many credit cards do not charge an annual fee. Look for a no annual fee card that also offers a low interest rate compared to other cards.

What are the advantages of credit?

Among other benefits, revolving credit offers:

- **The quick and easy ability to borrow money when you need it.**
- **An interest-free loan on purchases made using your credit card if you pay your balance in full each month by the due date. (Credit card cash advances begin to accrue interest immediately, so you will pay some interest on cash advances even if you pay them off in the same month.)**
- **The ability to finance (carry over from month to month) the debt if you can't pay the balance in full.**
- **Payments and finance charges that are based only on the amount of credit you use, not your entire credit line.**
- **Access to a credit line that can be used over and over again, up to an assigned limit.**
- **Protection against merchant and bank billing errors and unauthorized or fraudulent transactions, if you use a credit card to make your purchase.**
- **The possibility of getting an increased credit line if you need to borrow more money.**

What are the disadvantages of credit?

Credit is not always the best choice for every individual or under all circumstances:

- **Credit cards offer "unsecured" credit because your credit line is not guaranteed by property, such as a home or car. This means that credit cards generally carry higher interest rates than mortgages or car loans.**
- **If your balance is not paid in full, credit card purchases will cost more than cash purchases because of the added interest.**
- **Because a line of credit can be used over and over again, it is possible to remain in debt indefinitely.**
- **Credit line increases may make it easier for individuals who do not manage credit wisely to get deeper and deeper in debt.**
- **A home equity line of credit (HELOC), which is secured by your home, puts your property at risk if you can't make the payments.**
- **The availability of credit may be a temptation to take on debt in order to purchase things that are wanted, but not necessarily needed.**

Your rights

The Equal Credit Opportunity Act does not guarantee that you will receive credit, but it prohibits a creditor from denying your request for credit based on factors such as race, gender, marital status, national origin or religion. If you are denied credit, you have a legal right to know why.

You also have the right to up-front disclosure of all credit terms ("truth in lending"), including fees, interest rates, and other details about how much you will pay for the credit and how those charges are calculated. This will help you compare credit offers and make the best choice.

You are entitled to one free credit report every 12 months, upon your request, from each of the three national credit reporting companies: Equifax, Experian and TransUnion. You can obtain your reports for free online (www.annualcreditreport.com) or by calling 877-322-8228.

You're also entitled to a free report if a company denies your application for credit and you request your report within 60 days. The lender must provide you with the name and contact information for the credit reporting company that provided the negative credit information.

How many credit cards do you need?

Most people do not need more than two credit cards.

Look for one card with a low interest rate to use when you might need to extend the payment time for occasional emergency purchases.

For everyday purchases, consider another card that offers you a reward, such as airline miles or a cash rebate. Pay this card in full every month.

Try to keep the outstanding balance on your credit card below 50% of your credit limit. "Maxing out" your credit line lowers your credit score and makes it that much more difficult to get out of debt.

How to use credit wisely

The best way to avoid the potential pitfalls of credit—high costs and growing debt—is to use credit carefully. Try to use cash to purchase everyday items such as groceries, gasoline, clothes and restaurant meals. If you choose to take advantage of a rewards-type credit card to make these kinds of purchases, try to pay the balance in full each month.

When you want to make a large purchase—a television or a piece of furniture, for example—wait until you have saved enough money to buy it. That way, even if you use a credit card to make the transaction, you will be able to pay the bill in full and avoid finance charges.

An emergency fund—savings earmarked for an emergency such as a major car repair—will help you avoid financing a large, unexpected expense.

When you do use credit, follow these guidelines:

- **Pay at least the minimum required payment by the due date each month to avoid late fees and preserve or improve your credit score.** (Your credit score is a three-digit number that summarizes the information in your credit report. Lenders in general are more willing to extend credit to borrowers with higher credit scores.)
- **Pay your balance in full whenever possible.** If you choose to carry over a balance, make sure you have the ability to pay more than the minimum due so that you could reach a zero balance again in a few months.
- **Do not exceed your credit limit or you will be charged an over-limit fee.**
- **Do not use your home as an ATM. Use a HELOC only for a financial emergency or for major expenses like car or home improvements, or education costs, and only if you can afford to make the monthly payments until the balance is paid off.**

Assistance and information

Always try to resolve billing errors and other problems directly with your creditor. If you are not able to resolve a dispute, ask the creditor for the name of its regulatory agency. Then contact the appropriate agency listed in this section.

Federal Trade Commission (FTC)

877-382-4357 (877-FTC-HELP); www.ftc.gov
Regulates stores, finance companies, mortgage companies, credit bureaus and non-FDIC-insured financial institutions. Provides free credit education materials.

Federal Reserve System

888-851-1920; www.federalreserve.gov
Investigates complaints against state-chartered banks that are members of the System.

Federal Deposit Insurance Corporation (FDIC)

877-275-3342; www.fdic.gov
Regulates state-chartered banks that are not members of the Federal Reserve System.

National Credit Union Administration (NCUA)

800-755-1030; www.ncua.gov
Regulates federally chartered credit unions.

Office of Thrift Supervision

800-842-6929; www.ots.treas.gov
Regulates federal and state savings banks and savings and loan companies.

Comptroller of the Currency

800-613-6743; www.occ.treas.gov
Regulates banks with “National” in the name, or N.A. after the name.

HUD (Housing and Urban Development Department)

800-669-9777; www.hud.gov
Handles complaints alleging discrimination in housing and mortgage lending.

Credit to Avoid

Some types of credit are a much better deal for the lender than for you. Here are two types of credit you might want to stay away from:

Car title pawn: The lender requires you to sign over the title to your car as security for a short-term loan representing just a fraction of the vehicle’s value. If you can’t repay what can be exorbitant finance charges and fees, the lender can take your car.

Payday loan: This is a cash advance loan on a post-dated check, from your next paycheck or the next direct deposit into your account. The effective interest rates on these loans—well above 250% APR—make them difficult to repay, locking you into a cycle of refinancing a growing debt.

Consumer Action

www.consumer-action.org

221 Main Street, Suite 480

San Francisco, CA 94105

415-777-9635 / TTY: 415-777-9456

hotline@consumer-action.org

523 W. Sixth Street, Suite 1105

Los Angeles, CA 90014

213-624-8327

Chinese, English and Spanish spoken



Consumer Action created this publication in partnership with Chase.

© Consumer Action 2009

STAYING ON
TRACK WITH
CREDIT

How to use credit wisely

A Consumer Action Publication