A Guide to Credit*

What you need to know about getting, using and keeping credit

*If you would like to receive a copy of this brochure, call 1-800-32-SMART

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This brochure is an overall guide about credit in your life.
For information specific to your situation,
seek the advice of a financial services counselor.

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What credit is all about

Used properly, credit can help you finance the things you need, such as cars, homes, appliances and education. You also can use credit to purchase luxuries like big-screen televisions or much-needed vacations. In short, credit gives you financial flexibility.

This guide is designed to help you understand what credit is, how to get it and how to use it wisely, whether you're just starting out or have been using credit for years.

In this guide, you'll discover:

- Establishing credit is as easy as opening a checking account or obtaining a credit card.
- Determining how much you can afford for a vehicle or major appliance is as easy as comparing your monthly expenses vs. your monthly income after taxes.
- Obtaining a home equity loan can help you make home repair, consolidate debt and finance your child's college education.
- The Federal Fair Credit Billing Act protects you when you use credit.
- Avoiding credit troubles can be done by setting and sticking to a realistic budget. Gaining financial security is easier when you use your credit wisely.
- Getting a copy of your credit reports is easy. Simply contact one of three national credit reporting agencies.

Establishing credit in the early years

The early years in your credit life are crucial for building a strong credit foundation. Establishing good credit gives you buying power when you need it.

Q

Why do I need credit?

A

Building a good credit foundation is essential for buying homes, cars and many of the things you want. Without it, you're considered a credit risk. Also, you often need a credit card to reserve and rent such things as automobiles and hotel rooms. The convenience of shopping by phone is another reason to obtain a credit card.

Q

How do I establish credit?

A

If you don't currently have one, the first step is to open a savings and checking account at your local bank or credit union. Such accounts are often taken into consideration by lending institutions as evidence that you have money and know how to manage it.

Q

How do I keep good credit?

A

Having a realistic budget, keeping a moderate credit limit and paying balances every month are the keys to good credit. When you're starting out, credit companies will not give you a large credit limit, but you still have to be careful. Don't extend your credit too far if you can't make the payments.

Q

How much debt should I have?

A

Many credit counselors advise that monthly installment debt payments, such as car financing or school loans and credit card payments (not including a home mortgage), should not total more than 20 percent of your monthly income. For example, if your monthly take-home pay is $1,000.00, you should be devoting no more than $200 a month to credit payments.

Financing your vehicle

Good credit can put driving a new car or truck within your reach.

Q A **How can I determine what vehicle fits into my budget?**
Start with your monthly income after taxes and deduct your monthly expenses for fixed items like rent or mortgage payments, utilities and insurance. Then subtract your flexible items such as food, clothing, credit card payments and recreation. The money that is left over can be used to help determine the vehicle you can afford.

Q A **How can I reduce the amount I need to drive a new vehicle?**
One option is to save as much money as you can for the down payment prior to financing your vehicle. After all, the more you put down on a new vehicle, the lower your monthly payment. Another option is to trade in your current vehicle. In some cases, your old vehicle will take care of your new vehicle's down payment. Leasing is another alternative you should consider.

Q A **Should I finance or lease my new vehicle?**
If you like to drive a new vehicle every few years, need low monthly payments and prefer to avoid hassles, leasing could be for you. If you prefer to keep a vehicle for a longer period of time, buying your vehicle may be the right decision for you.

Q A **What are some other differences between buying and leasing a vehicle?**
When you lease a vehicle, monthly payments are usually lower than monthly purchase payments because you are paying only for the vehicle's expected depreciation during the lease term, plus rent charges (like interest), taxes, and fees. Other differences include:

Buying	Leasing
You are responsible for any pay-off amount if you end the finance contract early.	You are responsible for any early termination charges if you end the lease early.
You may drive as many miles as you want, but higher mileage will lower the vehicle's trade-in value.	Most leases limit the number of miles you drive (often 12,000-15,000 per year). You can negotiate a higher mileage limit and pay a higher monthly payment. You will likely have to pay charges for exceeding those limits if you return the vehicle.

When leasing a vehicle, consider:

- The agreed-upon value of the vehicle—a lower value can reduce your monthly payment;
- Any up-front payments;
- The length of the lease;
- The monthly lease payment;
- Any end-of-lease fees and charges;
- The mileage allowed and per-mile charges for excess miles;
- The option to purchase either at lease end or earlier; and
- Whether your lease includes "gap" protection, which protects you if the vehicle is stolen or totaled in an accident.

Ask for alternatives to advertised specials and other lease offerings.

When you lease a vehicle, you have the right to:

- Use it for an agreed-upon number of months and miles;
- Turn it in at lease end, pay any end-of-lease fees and charges, and "walk away";
- Buy the vehicle if you have a purchase option; and,
- Take advantage of any warranties, recalls, or other services that apply to the vehicle.

The federal Consumer Leasing Act and some state laws may provide you with additional consumer rights not covered in your lease agreement. For information on these laws, contact your state's consumer protection agency or Attorney General's office.

When financing your vehicle:

- Negotiate; financing is negotiable.
- Consider other terms such as contract length and down payment.
- Evaluate your financial situation. Determine how much you can afford to pay monthly. A longer-term finance contract may mean smaller monthly payments than a shorter-term finance contract (if all other terms are the same)—but will result in more money paid over time to the creditor.
- Comparison shop—Check annual percentage rates/finance rates/financing terms from at least three different financing sources, such as your bank, credit union or dealership.
- Select the options that you want. Some options, for example, rust protection and credit insurance, may raise the financed dollar amount of your vehicle. Make sure that the dealer includes only the items that you want in your contract.
- Read the contract carefully. Make sure that you understand the conditions before signing.
- Before you visit the dealer, determine the going price range of the vehicle you're thinking of buying. Check the newspapers ads, and auto magazines.
- Don't rush. Take the time to consider carefully whether the deal is best for your budget and transportation needs.

Purchasing a home

Home buyers today have more choices than ever when financing a home. Before you shop for a loan—or a home—make sure you learn as much as you can about the wide range of available options.

Q A

How much can I borrow for my home?

The amount you can borrow will depend on various factors, including the cost and value of your home, the amount of your down payment, your credit history, the amount of your other debts, your income, and the current mortgage rates. Generally, for loans, your monthly mortgage payment for principal, interest, taxes and insurance should not exceed 28 percent of your monthly pre-tax income. Monthly payments on other debts, such as car financing, school loans or credit card payments, should not exceed an additional 20 percent of your monthly income, depending on the amount of your down payment.

Q A

How do I estimate my monthly payments?

The worksheet below uses 28 percent and 48 percent figures to qualify, which are common. However, these percentages can be higher or lower, depending on the type of loan you select. A loan officer can tell you the different options available.

Q A

How much down payment will be required?

Borrowers with relatively small down payments may qualify for some mortgage programs. You will find that the higher the down payment you supply, the more types of loans and options may be available. The reason is that the lower your down payment, the greater the risk of nonpayment to your lender. To cover this risk, you may be required to purchase Private Mortgage Insurance (PMI), which protects your lender against losses incurred on loans with smaller down payments. The cost of PMI will be reflected in slightly higher monthly payments in addition to a fee paid at closing.

What are some home mortgage alternatives?

Basically, all mortgage loans are either fixed or adjustable rate. Fixed rate mortgages have an interest rate that stays the same throughout the life of the loan. Adjustable rate mortgages have an interest rate that moves up and down based on a formula tied to the movement of an economic indicator. Some mortgage alternatives include:

Monthly income before taxes

Borrower	$ ________			
Co-borrower	$ ________			
Other	+$ ________		Total monthly income	$ ________
Total monthly income	$ ________			x .48
	x .28			
Max. housing payment	$ ________		Max. payment for all debts	$ ________

Now calculate your monthly debts using the outline below.

Current Monthly Debts

Auto financing	$ ________
Personal loans	$ ________
School loans	$ ________
Minimum credit card payments	$ ________
Other current monthly debts	+$ ________
	$ ________
Maximum housing payment from above.	+$ ________
	$ ________*

*If this number exceeds that shown for maximum payment for all debts, figure the amount by which it exceeds that and subtract that amount from the maximum housing payment. The new figure is your maximum housing payment estimate.

Home Mortgage Alternatives

Loan Type	Loan Details
Conventional Fixed Rate	A mortgage loan in which the interest rate remains constant during the entire term of the loan.
Adjustable Rate Mortgage	A mortgage loan that permits the lender to periodically adjust the interest rate during the term of the loan based on movements of an economic index using a specified formula.
Balloon Mortgage	A mortgage loan that has level monthly payments that will amortize the loan over a stated term, but which provides for a balloon payment to be due at the end of an earlier specified term.
Graduated Payment Mortgage	A mortgage loan that has its initial monthly payments set at an amount lower than that which is required to fully amortize the debt. The payments are then increased by a specified percentage each year during the graduated payment period. At the end of the period, the payments are then set at an amount that will fully amortize the mortgage over the remaining term of the loan.

What can a home equity loan be used for, and is it tax deductible?

By using the equity in your home, you may also obtain a loan. You can use the proceeds of your loan to renovate your home, pay for college, take a vacation or consolidate other high-interest debts. Under current tax laws—depending on your situation—you may be able to deduct the interest because the debt is secured by your home. Consult your tax advisor regarding deductibility of interest.

When financing a home:

- Shop for a lender and consider more than the interest rates. There are other fees and charges. Lenders should provide this information to you, so that you can make comparisons.
- Consider requesting a credit-pre-approval decision from your lender. It will determine how much you may be able to afford. It can also speed up the mortgage process once you have found a home.
- Understand your credit standing. Your credit history may impact the interest rate that you will pay and the type of loan program for which you may qualify.
- Ask your loan officer if you may benefit from credit counseling services.
- Review all types of mortgage products offered by your lender. Discuss these options with your loan officer to determine what may work best for you.
- Ask your loan officer for a list of things to bring for your applications. Having the right documents may quicken the loan approval process.
- Remember that selecting a lender is your decision. Your real estate professional may offer an opinion about lenders, but the choice of a lender is yours.

A closer look at credit cards

Used properly, credit cards give you financial flexibility. With them you can take advantage of limited-time offers, travel with little cash, or handle an emergency.

Q **What are the benefits of having a credit card?**

A Credit cards give you the financial flexibility to purchase something today and stretch the payments out over months if you choose. Some cards offer cash back or rebates for products and services. Credit cards also offer security while traveling if your car breaks down or if you miss a flight. Most rental agencies and hotels require credit cards to rent cars and reserve rooms.

Q **What should I look for when selecting a credit card?**

A Select a card based on its total cost to you. To determine a card's cost, look at its annual fee and, if you plan to carry over a monthly balance, its finance charge. You might also want to consider a card which offers cash back or rebates for products and services.

Q **Do all credit cards allow you to roll over credit?**

A No. Some cards demand payment in full each month. These cards can be good if you're looking for the discipline of paying off your debt each month. They tend to have higher yearly fees, but do not add a finance charge.

Q **What kind of legal protection do I have with my cards?**

A If your cards are lost or stolen, you are responsible for contacting the companies that issued them as soon as possible. According to federal law, the most you can be held liable for is $50 worth of purchases. Even if the thief goes on a shopping spree, you're free of responsibility for anything over $50. (Liability will be less than $50 if you notify the card issuer before the unauthorized user incurs $50 of charges.)

Under the Federal Fair Credit Billing Act, when you make your complaint in writing, you may dispute a bill up to 60 days after the card issuer sends a bill with an error. Federal law helps you get credit for returned merchandise that doesn't work. The law also protects you from an unfavorable credit report about an unpaid charge while you're disputing the charge.

Answering your questions

Q How do I avoid large debt?

A Learning how to spend your money wisely is the first step, according to financial planners. Keeping a spending diary is a good way to see what you're buying and why, and can also help you set up a monthly budget. Gaining control of your credit cards is the next step. If you need your credit cards for convenience, strive to pay them off each month. If you can't control your charging, cut up your cards. Lastly, become a smart spender. Look for sales, clip coupons, and stick to your budget. For most people, some debt is necessary. But keep it to a minimum. Reducing debt is one of the best avenues to financial security.

Q What should I do if I can't make a payment?

A Contact the creditor immediately. In most cases, they will work with you depending on how much you owe. Try negotiating with your creditors to reduce payments. They would rather get smaller payments than none at all. However, if you find yourself in a situation where you don't have the money for the bill, you should contact the creditor immediately.

Q On average, what should I have saved for emergencies?

A You should always have three months' salary saved for occasions when you can't make a payment.

Q What can I do to improve my credit standing?

A
- Make sure you pay back everything you owe as soon as you can.
- Inquire at your bank about a consolidation loan. Then put away your credit cards except for emergencies.

- Take steps outlined in the first question on page 11 about committing yourself to controlling debt.
- Make sure your credit reports are factual by checking with the credit reporting agencies. See the next question about how to do this.

If you've had credit problems in the past, you might want to consider a secured credit card. These cards take away the risk to the lender, since the cardholder has money in the bank as security against default. This card can help to re-establish your credit, and provide you with identification when you write checks.

Q
A

Where can I get a copy of my credit report?

Simply contact one of the three national credit-reporting agencies. They are: Experian at 1-888-397-3742, Equifax at 1-800-685-1111, or Trans Union at 1-800-888-4213. If you have been denied credit, the reports may be free. Otherwise, the cost varies by provider. Keep in mind that every time you apply for credit, your financial history is closely scrutinized. It is important that there be no mistakes on your credit report. If you find an error in your credit report, be sure to contact all three credit bureaus to correct the error. The Fair Credit Reporting Act requires each credit agency to keep accurate records and investigate consumer complaints about information on their reports.

Remember: If you move, be sure to file a change of address with the post office, and notify your creditors of the change. If creditors can't find you, your account could become past due, and this could damage your credit standing.

Credit terms defined

Annual Membership or Fee An amount that is charged annually for having a credit card or home equity credit line. It is charged regardless of whether or not you use the card or credit line.

Annual Percentage Rate (APR) The cost of credit expressed as a yearly rate.

Cap A limit on how much a variable interest rate can increase or decrease during a predetermined period.

Closing Costs Fees paid by the borrower at closing to complete a mortgage loan transaction, including fees for preparing and filing a mortgage, taxes, title search and title insurance.

Credit Limit The maximum amount that you can borrow under the agreement of your credit account.

Home Equity The difference between the fair market value (appraised value) of your home and your outstanding mortgage balance.

Index An economic indicator on which your interest for a variable rate loan is based.

Minimum Payment The minimum amount that you must pay (usually monthly) on your account.

Security Interest An interest that a creditor takes in your property to secure a credit extension.

Variable Rate An interest rate that changes periodically in relation to an index using a specified formula. Payments may increase or decrease accordingly.

EQUAL HOUSING OPPORTUNITY