

Session 8

Credit and Debt

Protect Your Future

For today's lesson we are going to learn different aspects of credit and debt. Credit is borrowed money you can use to pay for things. The creditor (also known as the lender) trusts that you (the borrower) will pay them back later, usually with interest.

The earlier in life we build credit, the better it can be for us, provided we are building good credit of course. If we establish good credit early in life it will help us when we reach a point where we need a loan for a car, when we need to rent an apartment or even if we want to apply for a business loan.

Every single financial transaction you engage in – whether you pay your bills on time, if you miss some payments, how much debt you have – is tracked and recorded in a document known as your **credit report**. Some simple ways to build credit are by paying your bills on time and managing your checking account responsibly. Whether or not you have credit will affect almost every single aspect of your life.

It is important to not be tempted when you are young by things that may impact your credit negatively. Students in college can receive up to 5 credit card offers per month and almost all of us are tempted by this when we are younger. It may be nice to have a new card that can get you anything you want at a young age, but we have to remember that every purchase we make must be paid back and with substantial interest rates as well. It is easy to fall into a trap with credit cards at a young age so be sure to be mindful and responsible if you are ever tempted by credit cards.

Session 8 Continued

Understanding Credit Reports

As we mentioned before your credit report can have a big impact on your financial well-being. Here is what makes up your credit report:

1. Payment History – 35%
2. Total Amounts Owed – 30%
3. Length of Credit History – 15%
4. New Credit – 10%
5. Type of credit in use – 10%

As a teenager, there's nothing you can do about numbers 3 and 4 above. But as you can see, by using a budget, spending your money wisely and using credit cards responsibly (if you use them at all), you can focus on the #1 and #2 items that make up your credit score. Keep the amount you owe to a minimum, and always pay your bills on time.

As an example, to show the importance of your credit score, we have a scenario for you to look at. In this scenario you are borrowing \$10,000 to purchase a car. Now the rate you will receive depends on your credit score. Look at the chart: (Loan paid back in 36 months)

FICO Score (credit score)	APR (loan percentage rate)	Monthly Payment	Total Paid
720-850	5.149%	\$300	\$10,800
690-719	6.677%	\$307	\$11,052
660-689	8.61%	\$316	\$11,376
620-659	12.219%	\$333	\$11,988
590-619	17.958%	\$361	\$12,996
500-589	18.957%	\$366	\$13,176

As you can see, your credit score won't just determine whether or not you will get the loan. It will determine the TERMS of the loan – how favorable the interest rate is. In this example the person with the lowest credit score ends up paying about \$2,200 more than the person with the highest credit score. So even this one transaction, buying a car, cost the financially irresponsible person an extra \$2,000. Bad credit is a penalty you pay over and over again.

So keep your debts to a minimum – and **always** pay your bills – and pay them on time!

Session 8 conclusion

Today you were introduced to credit scores and shown ways that a negative score can affect your financial future. Understand if you know anyone who has struggled with a credit score issue in the past or if you struggle at some point in your life with yours, this is nothing to be ashamed of. Sometimes things come up that we cannot control and it may have an impact on our finances. The key point of this lesson and the Money Matters program is to try and take control of the situations you are able to. Financial decisions we can make, like prioritizing needs over wants, creating a balanced budget and always making our payments on time will help you build a good credit score and take control of your financial future.