Lesson 5
Credit

05

UNDERSTANDING CREDIT

In this section, we will learn what credit is, why it matters, and how your financial decisions affect it. The purpose of credit is for money lending institutions, such as large banks and loan associations, to measure how likely someone is to pay back money they borrow.

1. Complete the following matching exercise of definitions

Credit	A. A record of how you pay your debts such as bills, loans, and other types of credit.
APR (Annual Percentage Rate)	B. The entire amount of money a person owes to lenders.
Debt	C. A report of your credit history. This document will be used by creditors to determine if they want to let you borrow money or if they trust you to pay money in the future (for example, if a landlord trusts you will pay rent in the future).
Credit report	D. An amount of money someone is willing to loan another person based in trust and the expectation that the money will be repaid with interest. It enables you to buy something now and pay for it later.

Credit history	E. This is the agency that compiles information on how you pay your bills and how much debt you have. There are three main ones in the USA: Equifax, Experian, and TransUnion.
Credit reporting agency)	F. The cost of credit on an annual basis expressed as a percentage. It refers to the annual rate of interest charged to borrowers by a lending institution.
Credit score	G. A number assigned to a person that indicates to lenders their capacity to repay a loan. In other words, a number that indicates someone's likelihood to make payments in the future.
Loan	H. A sum of money that is borrowed and expected to be paid back with interest. This is a type of credit.

PURPOSE OF CREDIT

As we learned from the exercise above, credit is any amount of money that a lender such as a bank lets you borrow, or loans to you, under the assumption that you will pay it back in the future with interest. Examples of types of credit are:

- Revolving credit: when you are given a certain amount of credit over a specific time period that renews every time period.

    - Example: credit cards have a monthly credit limit. More information on credit cards is included in the next lesson.
        - Credit cards are the most commonly used and most accessible forms of credit. A credit card will probably be your first source of credit.
- Loans: when you are given a fixed amount of money with a contract outlining how long you have to pay back the money with interest.
    - Example: you may get an auto loan to buy a car now, and you'll pay the institution that gave you the loan instead of the dealership.
    - Example: student loans can help you pay college tuition. They can be helpful because the cost of tuition is due all at once, but student loans can be paid off over time after you finish college.
- Mortgages: a mortgage is a loan used to purchase property, such as a home. Even though you live in the house, a bank issued your mortgage. Therefore, the bank that gave you the loan will technically own the house until you have paid back the loan over many years.

Typically, if you are given credit, i.e. allowed to borrow money, you will make monthly payments with interest, as opposed to weekly or yearly payments. For example, if you have an auto loan worth 1000% with no interest (usually there is interest, we're assuming no interest in this example to keep things simple), you may be asked to pay back $100 each month. It's also possible that you might only be asked to pay back $75 each month. The amount that you need to repay each month and the interest rate should always be given to you before you agree to borrow the money.

- This is true for every type of credit. Do not agree to borrow money unless the lender has made clear how much is owed every

month, the interest rate, and any late fees that may apply if you do not make a payment on time.
- Most loans come from banks. Just like check cashing stores have high interest rates, loans given from institutions that aren't banks may also have high interest rates.

The examples above make it clear that being able to obtain credit, i.e. borrow money, is important because there are some purchases that are too big to make all at once. This is the main reason that credit is important. For example, most people can't buy a house all at once, they need to pay for it over a long period of time.

2. Read the following scenario, and respond as you would:

Imagine you are standing outside and a stranger asks you to borrow money so he can buy a car. He promises you that he will pay you back and that he is trustworthy; he says he always pays his bills on time and has always paid back borrowed money before. He says if you let him borrow money now, he will pay you back with interest, so you will wind up making a little money if you lend him money. Do you believe him? What evidence would you want to see in order to prove that he will pay you back?

Now imagine you are the manager of a bank and someone asks you for money to buy a car, i.e. they ask you for an auto loan. You probably want a guarantee that this person is to pay you back before you give them a loan. After all, you don't want to give someone money and then not get it back. As long as there's evidence that the person will pay back the loan, the bank should want to give the loan so they can make money off the interest. Credit scores and credit history reports give the evidence needed to show the lender that you will pay back the money you borrow.

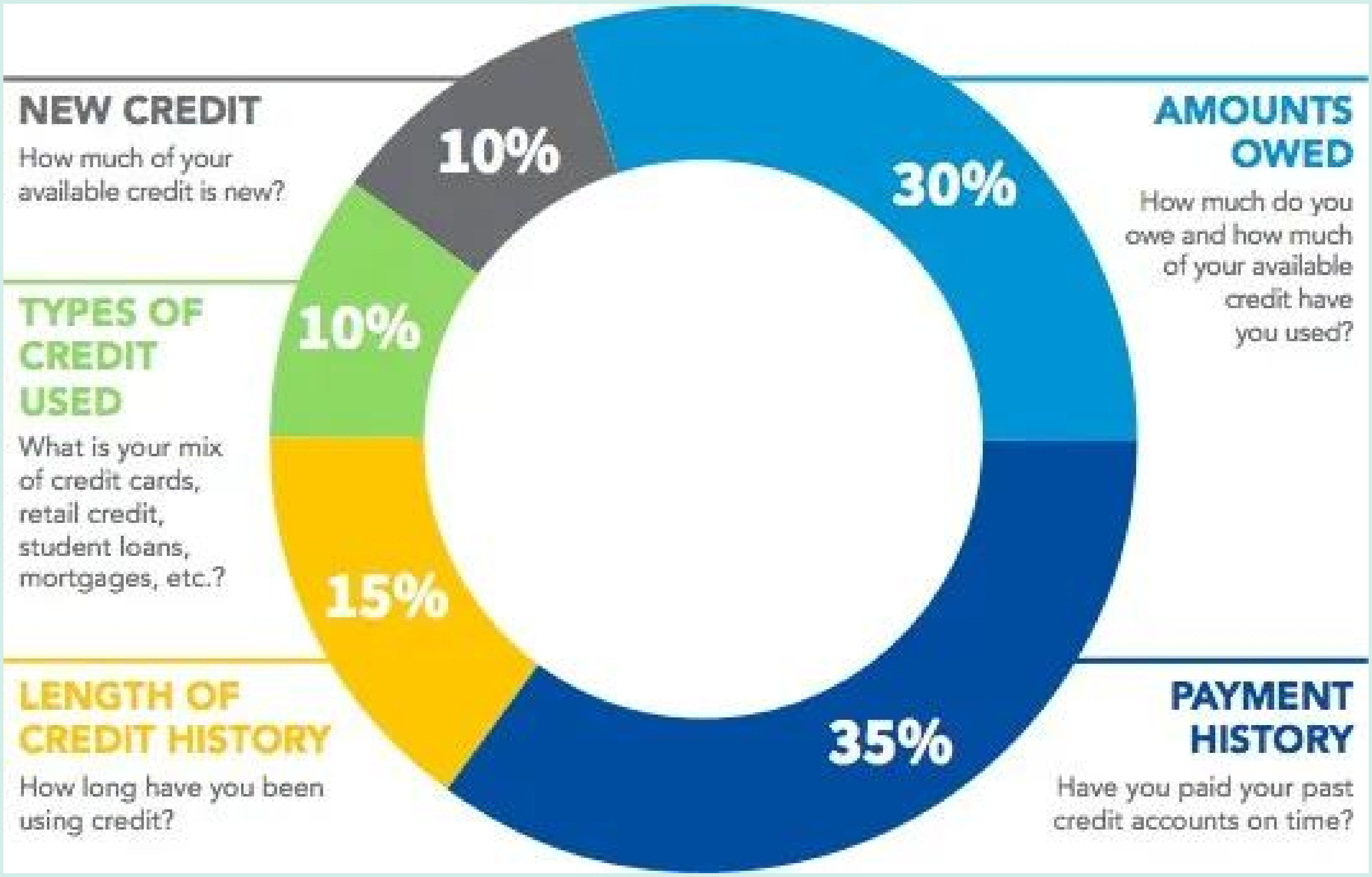
Each individual with a credit card or other debt has a credit score and a credit history report that credit-granting institutions as well as landlords can check. The credit score is a number that tells how well you've paid back credit in the past, and the credit history report is a more detailed record of the types of credit you've had in the past or currently and how well you've made payments on them. Since you will probably need to borrow money at some point, it's important to have a good credit score and a good credit history report.

Your credit report:

- Gives detailed information on the limits and amounts of your credit accounts (i.e. debts)
- Gives information on your payment history

Your credit score:

- Is a number between 300 and 850 that determines how "creditworthy" you are, or how trustworthy you are with credit
  - 300-629 is considered "bad" credit
  - 630-689 is considered "fair" credit
  - 690-719 is considered "good" credit
  - 730-850 is considered "excellent" credit
- The FICO score is a specific kind of credit score, and it is the one that the vast majority of credit-granting institutions and landlords will look at.
  - Your FICO score is determined by:
    - How much you currently owe
    - Your payment history
    - The length of your credit history
    - The types of credit you've used (for example, a credit card bill is different than rent, which is different than a car loan)
    - How much of your credit is new
  - The different factors listed above have different levels of importance in calculating your FICO score:



reference: https://www.salliemae.com/assets/products/landing/FICO/understanding-credit-handbook-pdf.pdf

- Your credit score determines if a lender will approve you for credit, how much you'll be allowed to borrow, and what your interest rate will be.
- Your credit score is one factor that landlords look at when determining whether to rent to you, but not the only one

Activity: Watch the following activity on credit scores and answer the questions in the video https://edpuzzle.com/media 5bb7806002f6464047da2d50

Since being able to borrow money, i.e. being able to obtain credit score is what determines whether someone lends you money, it is very important that you build good credit, which means have a "good" or "excellent" credit score.

When you first arrive in the United States, you will have no credit score unless you've held a US credit account before. In the next section, we will talk about ways to build good credit and behaviors to avoid.

BUILDING GOOD CREDIT

The way to build good credit is to show that you can pay back debts and credits. It may not seem like it, but bills for services that you pay for after the service has been rendered counts toward your credit (example: paying a water bill for the past 30 days of water in your home).

Important habits to build good credit:

- Pay all of your bills on time.
- If there's a bill you don't think you can pay on time, for example you get paid on the 15th of the month and the bill is due on the 13th, call the company who issues the bill and ask if they can move your payment date back or if you can have a grace period.
- This includes: phone bill, electric bill, water bill, gas bill, insurance, etc.
- Pay your rent on time. Not all landlords report good or bad rent paying to the credit reporting agencies, but some do.
- If you don't have credit yet and you want your rent to help you build credit, you can ask your landlord to report your good monthly rent payments to credit reporting agencies.
    - Only ask for this if you are paying the full amount of your rent on time every single month.
- Repay your IOM loan in a timely matter.
- More information on the IOM loan is given in the next section.
- This loan is designed to help you build credit with attainable

monthly payments, repaying this loan is one of the best ways to help your credit.

- Pay any other loans on time, always.
- Example: student loans
- Be responsible with your credit card. Pay off the balance monthly, do not ever miss payments, and be mindful of how much you use it (this is called revolving credit utilization).
- More information on credit cards is given later in the lesson.
- Borrow money from a non-profit lending circle.
- There are non-profit organizations that give loans to individuals with financial need to help them build credit while helping them finance various things.
- Example: https://missionassetfund.org/lending-circles/
- Eventually once you have established some credit, you can take out an auto loan if you need to buy a car. Having different types of credit, such as good bill payments and an auto loan, can ultimately help your credit score. This is advanced, and is usually not a good idea until you've already established somewhat good credit.

Things to avoid when trying to build good credit:

- Paying bills late.
- Paying rent late if your landlord informs a credit reporting agency (they may or may not, you can ask)
- Having too many credit cards or credit cards with high interest rates
    - More information on this later in the lesson
- Not making IOM loan payments on time

Now that you know the things to do to build good credit, you may want to check your credit. It typically takes at least several months, usually a couple of years, to build good credit, so don't get discouraged if you haven't started yet. It's never too soon to start. You can check your credit for free once per year through annualcreditreport.com. Be careful not to check it too often or check it through untrustworthy sources, as checking it too much can actually lower your credit score. You can ask your bank what the safe ways to check your credit are.

If you accidentally miss a bill payment, or do any of the other things to avoid when trying to build credit, the best way to save your credit is to try not to let it happen again. A lot of companies will try to work with you to help you pay your bills by moving the payment date, informing you of a payment grace period, or helping you pause your service for things like internet/cable temporarily until you can pay. If you miss a payment, just try to get back on track next month. **Consistent good behavior over a long period of time is the most important thing when building good credit.**

3. Flores is trying to build good credit. Read the following scenarios in her life and in the blank write "yes" if you think she should do this to help her credit score, and write "no" if you think it would not help her credit score.

1. _______Flores wants to go to the movies with her friends. It will cost $20 total for a ticket and popcorn. Her water bill is also $20. If she goes to the movies, she will have to pay her water bill 2 weeks late.

2. _______Flores took out a small student loan to attend community college. Now that she's done, she has to start making payments on her student loan. She is planning on paying off the monthly payment of her loan, plus the interest

she owes, on time every month.

3. _______Flores has been paying rent on time for 8 months now, and she knows she can continue to pay on time for the rest of the time she is living there. She is thinking about asking her landlord to report her rent paying behavior to the credit reporting agencies.

DEBT TO INCOME RATIO

In general, you never want to have too much debt. For example, if you owe $1500 each month in debt and you make $2500 each month, it's going to be very, very hard to pay off your debt and make the monthly payments. A good goal is to make sure your debt never exceeds 36% of your total income. For example, if you make $2000 each month, you never want to owe more in debt than $720.

INTERNATIONAL ORGANIZATION FOR MIGRATION (IOM) LOAN REPAYMENT

The IOM loan is an interest-free loan given to refugees to cover their cost of travel to the United States. Refugees sign a promissory note, which states that they will repay the amount of their loan within a certain amount of time (often over four years). Recipients of the loan are required to begin making payments six months after arriving in the country. Payments are generally due on the 15th of each month.

If you are a refugee and you received an IOM loan, making your loan payments on time each month is an easy way to build good credit in the United States, which is very important to have (as discussed above).The amount that a person owes each month depends upon the agreement that was signed. If a loan was for $1,500 and was promised to be paid back in four years, the person would owe about

$33.00 per month. This is in addition to any other expenses, like rent, food, and transportation. Although you will not be charged more money if you do not pay on time for this loan, it will still hurt your credit score if payments are late or missed. Make sure that you have enough money to cover the cost of all expenses, including the loan payment.

If you are unable to make a payment on your loan or cannot pay the full amount, you should contact your resettlement agency immediately.

FICO SCORE “RED FLAGS”

A red flag is something that negatively impacts your credit score. Many of them are common such as:

- Requesting more than one credit card in a 6-month period
- Having several department store cards
- Having several credit cards with high interest rates
- Having a bankruptcy/foreclosure on your report

To improve your credit score:

- Pay off revolving credit cards (cards that only require a small minimum payment) as soon as possible
- Do a Balance Transfer from a high interest account to a low interest account, but be sure to note when the low interest transfer ends so that you can make any changes needed
- Dispute a balance on a credit card (especially if you recently paid off the card) online. It will have faster results than if you write a letter

Watch this video and take the quiz to learn more ways to improve your credit card score:

How To Correct Errors On Your Credit Report https://edpuzzle.com/media/5fb5b3de4daa2340800222c7

ANSWER KEY

1. Credit—D
   DAPR—F
   Debt— B
   Credit History—A
   Credit Report—C
   Credit Reporting Agency—E
   Credit score: G

2. This is up to you. You might want to see proof that he has paid back other loans, proof that he has paid his bills on time, proof that he has paid his credit card on time.

3. a. No,
   b. Yes,
   c. yes