LESSON PLAN

LESSON TITLE:	Credit
INSTRUCTOR:	
TEACHING METHOD:	Informal lecture & discussion
INSTRUCTIONAL AIDS:	
CLASS TIME:	2 Hours
LESSON OBJECTIVE:	Provide participants with a fundamental understanding of credit and teach them how to make informed decisions concerning credit. Participants should be able to acquire the following desired learning objectives:

- Establish personal credit
- Explain personal credit rights and responsibilities
- Request credit reports and evaluate credit ratings
- Calculate a personal debt ratio
- Arrange credit usage based on a personal budget or spending plan
- Explain the responsibilities of government credit card use
- Manage prior credit choices and make informed decisions concerning joint credit use

LESSON PLAN MAIN TOPICS

1. Credit: What Is It?

2. Credit: What Does It Cost?

3. How To Apply For Credit

4. How the Law Protects You-and How You Can Protect Yourself

5. How To Establish a Credit Record and Correct Credit Mistakes

6. How Much Credit Can You Handle?

7. Government Credit Cards

LESSON OUTLINE

A) INTRODUCTION

B) SUBJECT MATTER

I. Credit: What Is It?

A. Definition

B. Uses

C. Types Of Consumer Credit

D. Key Credit Terms

II. Credit: What Does It Cost?

A. Problems of Credit Use

B. Cost of Credit

C. How To Compare Credit Cards

III. How To Apply for Credit

A. Opening A Charge Account

B. Factors That Influence Your Credit Worthiness

C. Equal Credit Opportunity Act

D. What To Do if Your Credit Application is Denied

IV. How the Law Protects You-and How You Can Protect Yourself

A. Limits on Finance Rates

B. What To Do if a Creditor Fails to Disclose Information: TILA

C. In Case of Billing Error

D. Your Credit Rating during Dispute

V. How to Establish a Credit Record and Correct Credit Mistakes

A. Establishing Credit

B. Joint Credit Use

C. Credit Reports and Correcting Information in Your Credit File

VI. How Much Credit Can You Handle?

A. Long-Standing Rules

B. Determine Your Credit Ceiling

VII. Government Credit Cards

A. Avoid Problems Using the Government American Express

B. Penalties for Abuse of the Government American Express

C) REVIEW

TEACHING PLAN

INTRODUCTION

ATTENTION:

MOTIVATION:

OVERVIEW: Main Topics

TRANSITION:

SUBJECT MATTER

I. Credit: What Is It?

A. Credit is a form of trust established between a lender and a borrower. If the lender believes that a prospective borrower has both the ability and the willingness to repay money, then credit will be granted. The borrower will, hopefully, live up to that trust and repay the lender.

B. Uses

Emergencies - To pay for unexpected expenses, such as emergency medical services or auto repairs.

Early consumption - Buying on credit allows the consumer immediate use of the product.

Convenience - Using credit, and credit cards in particular, simplifies making many purchases. It provides a record of purchases and it can be used as leverage in disputes over purchases.

Education - The growing cost of higher education forces many to borrow.

Offsetting inflation - Many people borrow money to buy a product before inflation causes the price of the product to rise.

Debt consolidation - Many consumers who have difficulty making credit repayments turn to a debt-consolidation loan. Here the borrower exchanges several smaller debts with varying due dates and interest rates for one payment, which is usually lower in amount than the payments on the other debts combined. For the privilege of consolidating all debts into one, the consumer is charged a substantial interest rate and the term of the loan is lengthened which, in spite of higher interest charges, allows for lower monthly payments.

Free credit - Credit card users may be provided free credit for short periods of time, up to 50 to 55 days, depending on the timing of a purchase.

The good life - People use credit as a way to raise their level of living in anticipation of higher incomes in the future.

Making reservations - Most motels and hotels require some form of deposit in order to hold a reservation for arrivals past 6 p.m. Providing a credit card number usually will serve as such a deposit, allowing guaranteed reservations to be made over the phone. (If you decide to cancel the reservation, generally you must do so by 6 p.m. in order to avoid credit card charges.

C. Types of Consumer Credit

Closed-End Credit - Mortgage loans, automobile loans, home improvement loans and installment loans for purchasing furniture or appliances are examples of "closed-end" credit. It is used for a specific purpose and is for a specified amount. An agreement or contract lists the repayment terms--the number of payments, payment amount, and how much the credit will cost.

Open-End Credit, sometimes referred to as revolving credit, is using a credit card issued by a department store, a bank credit card (VISA, Mastercard), or Deferred Payment Plan (DDP) to make purchases. Unlike closed-end credit, you do not apply for open-end credit for a single purchase. You may have to pay interest, a periodic charge for the use of credit, or finance charges. Billing procedures may vary between creditors. Some creditors allow you 30 days to pay the bill in full and not incur any interest charges. This is called "convenience credit."

Public Utilities Credit - Power, water, gas and telephone companies charge customers for their services after they've been used. How much you pay depends on how much you use. By allowing customers to pay later, utility companies are granting credit even though there are no formal credit agreements or credit charges.

D. Key Credit Terms

Grace Period - The amount of time, usually 25 days, that you have to repay any credit purchase without paying a finance charge (interest). Grace periods only apply to purchases made with a zero balance on your previous bill. If you have an outstanding unpaid balance, you do not get a grace period.

Billing Date - The last day of the month on which any transactions are reported. Any purchases after this date will be recorded on the following month's bill.

Due Date - The time by which the credit card company should receive payment from you. Most credit card companies permit payment to be made a few days past the due date, since mail is sometimes slow. However, if payment is received later than the due date the customer is legally obligated to pay finance charges. If no payment is received by the due date, the card holder is in default (has failed to meet legal financial obligations). The company will then begin their own internal collection efforts, usually by first mailing a notice that a payment is overdue.

II. Credit: What Does It Cost?

A. Problems of Credit Use

Perhaps the greatest disadvantage of credit use is the loss of financial flexibility in personal money management. For example - if you have installment debts taking 10 percent of your after-tax income, you have lost the opportunity to spend those dollars for something else.

Credit use also reduces your future buying power, since the money you pay out in a three-year installment loan includes a finance charge, or what the lender charges you to borrow the money.

Credit use often leads to overspending. Buying clothes on a charge account for $25 a month for twenty months seems a lot easier than paying a full purchase price of $425. It is easier still to buy more clothes on credit the next month, especially if you have more than one credit card.

Overextension of credit can also be a real problem for credit users. By the time a consumer has installment debts amounting to 20 percent of take-home pay, he or she is seriously in debt. Instead of working at a job and spending the income, the consumer slaves at a job to pay the bills.

Misusing credit and not paying bills on time can give a consumer a poor credit reputation or even result in the loss of items purchased.

B. Cost Of Credit

Annual fee - Credit cards issued by financial institutions often have an annual fee of $15-$25, and some have fees as high as $45-$60 if they are "premium cards" that provide the consumer a higher line of credit.

Late fee - Most credit card issuers charge a late payment fee of five percent of the amount past due.

Over-the-limit fee - Some financial institutions charge a fee of $10-$15 each time you exceed your credit limit; that is, the maximum amount that the bank will let you borrow.

Variable-rate provisions - Some credit card issuers set APRs (annual percentage rates) that vary with an interest rate index, such as the published market rates on three year U.S. Treasury bills.

The Method Used To Calculate Balance - Two cards that advertise the same interest rate could actually vary widely in cost, depending on how the average balance is calculated. Typically the interest is calculated by first computing the average daily balance. This is the sum of the outstanding balance owed each day during the billing period, divided by the number of days in the period. Next the interest is applied against that balance.

Two other methods are frequently used. In the "previous-balance" method, finance charges are levied on the previous due balance as of the beginning of the billing period. The "adjusted-balance" method levies the charge on the amount of the previous balance minus any payments made during the billing period. Thus, the adjusted-balance method results in the lowest finance charge, the previous-balance method is the highest charge, and the average-daily-balance method is somewhere in between. All credit card applications and promotional offers include a chart listing the method of balance calculation and other important information about interest rates and fees. You can call your bank to find out how your current credit card interest balance is calculated.

(HANDOUT - THE HIGH COST OF BORROWING)

(HANDOUT - INTEREST RATE BASICS)

C. How to Compare Different Credit Cards

Two major costs make up the price of a credit card. One is the interest rate (or annual percentage rate (APR)) charged on outstanding balances. The other is the annual fee. Of course, not all cards have both low annual fees and low interest rates.

Here's a rule of thumb to compare cards, depending on your credit habits:

- If you pay off your balance every month, look for a card with a low or no annual fee.
- If you make payments within the grace period you don't pay interest.
- If you carry a balance, you will pay interest and finance charges and you should look for a low interest rate card.

III. How to Apply for Credit

A. Opening a Charge Account - Obtaining credit is a three-step process.

Fill out a credit application. The application will request information about your ability and your willingness to repay.

Credit history investigation. The lender generally conducts a credit investigation of your financial history and compares that information with your application.

Credit scoring of your application.

B. Factors that influence your credit worthiness:

Your ability to repay the debt- what your current job or income source is, how long you've worked or will receive that income, how much you earn, what your current expenses are: rent or mortgage payment, current credit payment, or average yearly family-related costs such as food, clothing, and school tuition.

Your credit history - how much money you owe, how often you borrow, whether you pay bills on time, and whether you live within your means.

Signs of stability - how long you have lived at your current or former address, how long you have been employed, whether you own a home or rent.

Your assets (car, home, etc.) - what can be used as collateral for your loan, and what sources you may have for repaying the debt other than income, such as savings or investments.

C. Equal Credit Opportunity Act

Whatever credit standards lenders choose to follow, they are required by law to apply them fairly and impartially.

The ECOA prohibits lenders from discriminating against you in any part of a credit dealing. Basically, a lender may not use age, race, color, national origin, sex, marital status, or religion against you.

D. What To Do if Your Credit Application is Denied

Under the Equal Credit Opportunity Act, you must be notified within 30 days after your application has been submitted whether your application has been approved or not.

If denied credit, it must be in writing and must list specific reasons for denying credit or tell you how to request an explanation.

If the decision was based on a credit report you must be told which credit reporting agency was used and their address.

If you are denied credit without an explanation, first request that you be given an explanation in writing as required by law. If you believe you have been discriminated against, tell the lender why you think you've been discriminated against, and try to resolve the issue through negotiation. If the lender still refuses to extend you credit and hasn't given you a satisfactory explanation, contact your state's attorney general's office or consult a lawyer for assistance.

IV. How the Law Protects You And How You Can Protect Yourself

The Truth in Lending Act (TILA) helps you choose credit wisely by requiring lenders to provide you with information that will help you make a decision whether it is worth the finance charge to have goods and services now rather than later. It requires standardization of credit figures. Lenders must report both the total finance charge in dollars and the annual percentage rate of interest. The APR is a measure of the cost of credit at a yearly rate expressed as a percentage. For example, a $1,000 single payment one year loan at 14 percent APR carries a finance charge of $140.

A. Limits on Finance Rates

The shopping around you do for closed-end credit (installment loans) or open-end credit (revolving or credit accounts) is a key factor to limiting and minimizing finance charges you have to pay.

Most states impose rate ceilings (known as usury rates) on various lenders or types of credit. For example, the rate that finance companies may charge and the rates that retailers may charge citizens who hold their credit cards is controlled by these usury laws.

If you believe that a lender has charged you or tried to charge you a finance rate that exceeds the rate ceiling in your state, you should contact the office of your state's Attorney General.

B. What To Do if a Creditor Fails to Disclose Information : TILA

If a lender fails to disclose information required under the Truth in Lending Act, gives you inaccurate information or does not comply with the rules about credit cards, you should inform the federal enforcement agency.

You may bring a lawsuit for actual damages (any money loss you suffer). In addition, you can sue for twice the finance charge. The least a court may award you is $100 and the most is $1000. If you win the lawsuit, you will also be entitled to court costs and attorneys' fees.

C. In Case of Billing Error

The Fair Credit Billing Act (FCBA), sets procedures for promptly correcting billing mistakes, for refusing to make credit-card or revolving credit payments on defective goods, and for promptly crediting your payments. The act defines a billing error as any charge for something you did not buy or for something bought by a person not authorized to use your account. Also included among billing errors is any charge that is not properly identified on your bill, that is, for an amount different from the actual purchase price, or that was entered on a date different from the purchase date. A billing error may also be a charge for something that you did not accept on delivery or that was not delivered according to agreement. Finally, billing errors include errors in arithmetic; failure to reflect a payment or other credit to your account; failure to mail the statement to your current address, provided you notified the creditor of an address change at least 20 days before the end of the billing period; and questionable items or items on which you need additional information.

If you think your bill is wrong or you want more information about it, follow these steps. First, notify the creditor in writing within 60 days after the bill was mailed. Be sure to write to the address that the creditor lists for billing inquiries. The letter should include your name and account number and a brief statement as to why you believe the bill contains an error and what you believe the error to be. State the suspected amount of the error or the item you want explained. Then pay all the parts of the bill that are not in dispute. While waiting for an answer, you do not have to pay the disputed amount or any minimum payments or finance charges that apply to it.

The creditor must acknowledge your letter within 30 days, unless your bill can be corrected sooner. Your account must be corrected or you must be told why the creditor believes the bill is correct within two billing periods, but in no case longer than 90 days. If the creditor made a mistake, you need not pay any finance charges on the disputed amount. Your account must be corrected, and you must be sent an explanation of any amount you still owe.

If no error is found, the creditor must promptly send you an explanation of the reasons for that determination and a statement of what you owe, which may include any finance charges that have accumulated and any minimum payments you missed while you were questioning the bill.

D. Your Credit Rating during Dispute

A creditor may not threaten your credit rating while you are resolving a billing dispute. Once you have written about a possible error, a creditor is prohibited from giving out information that would damage your credit reputation to other creditors or credit bureaus. And until your complaint has been answered, the creditor may not take any action to collect the disputed amount.

If your bill was not in error, the creditor may report you as delinquent on the amount in dispute and take action to collect if you do not pay in the time allowed. Even so, you can still disagree in writing. Then the creditor must report that you have challenged your bill and give you the name and address of each recipient of information about your account. When the matter has been settled, the creditor must report the outcome to each recipient of information. Remember that you may also place your version of the story in your credit record.

V. How to Establish a Credit Record and Correct Credit Mistakes

A. It may seem to many first-time borrowers that in order to get credit you have to have credit. There are many ways you can begin to build up a good, solid credit history, for example you can:

Act on some factors you can control. Establish both a checking and a savings account. Avoiding overdrafts on a checking account and making regular deposits to a savings account may be good financial management, but the lender only wants to know that you have a checking and a savings account.

Visit a local retail establishment. Tell them that your intention is to establish a credit rating, and request an account. A local retailer is more likely to open a limited account if you visit the store in person and dress neatly. Once the account is open use it to make a few purchases for which you typically use cash. When the bill arrives, pay it promptly and in full. Presto, a credit history is established.

Request and acquire an oil company credit card. Although more difficult to obtain than a local retail credit account, these are not impossible to get. Should one company refuse, apply at another, as scoring systems differ. Again, use the credit sparingly once obtained and repay promptly.

Apply for a bank credit card. Most bank card companies have a program of test credit for people without an extensive credit history. The limit on credit purchases may be $50 or $300, but once again the opportunity then exists to establish a credit rating. Later you can request an increase in the credit limit.

Ask a bank for a small short-term cash loan. Putting these funds into a savings account at the bank will almost guarantee that you will make the required three or four monthly payments. Also, the interest charges on the loan would be partially offset by the interest earned on the savings.

Get someone to cosign a loan with you. The person will be responsible for the debt if you can't pay, thus securing your first loan on the basis of someone else's credit. After the loan is repaid, you will find it easier to secure credit on your own.

B. Joint Credit Use

Spouses should establish credit records in their own names while still married, especially if they do not earn wages. Many do not do this. When the non-earning spouse is divorced or widowed, and does not have an established credit history separate from the former spouse, the Equal Credit Opportunity Act requires lenders to consider the credit history of any accounts held jointly with the former spouse. Lenders also are required to look at the credit record of any account held only in the former spouse's name if the non-earning spouse can show with checks, receipts or other records that it also reflects his or her own creditworthiness. Likewise, if the former spouse's credit record is unfavorable, the non-earning spouse may show that the record does not reflect his or her own creditworthiness by producing previous explanatory letters sent to lenders, copies of contracts signed solely by the spouse, receipts or other evidence.

C. Credit Reports and Correcting Information in Your Credit File

Nationwide credit bureaus maintain computer files of financial payment histories, public record data, and personal identifying data and provide copies to authorized credit grantors.

The lender, not the credit bureau, decides on your credit rating, which determines whether credit is granted to you. Scoring systems developed by most lenders help reduce subjectivity in decision making, avoid discrimination, and improve the likelihood of making correct decisions. However, since types of credit and credit applicants vary, each lender uses different scoring techniques. Lenders typically use computers to analyze credit files and determine credit scores. In evaluating a credit application, lenders consider the five C's of credit.

> Character - involves your honesty and reliability in meeting financial responsibilities. Your previous credit history indicates how highly you value paying bills on time.
>
> Capital - a measure of your financial net worth. Questions about assets (home ownership, stocks, savings accounts) and liabilities (balance due on present credit accounts) reveal whether net worth is positive or negative (owing more than is owned).
>
> Capacity - the income available to make repayment. Having a substantial income, having the same job for a number of years, and not having a lot of other debts suggests a strong financial capacity to repay.
>
> Collateral - generally includes all the assets you possess that could be available to meet liabilities.
>
> Conditions - the general credit economy. When government and/or market conditions result in a restriction in the supply of money, less money is available for lending. In such cases, many applicants would be rejected who would normally have been approved for credit. Conversely, when large quantities of money are available, especially at low interest rates, it is much easier to obtain credit.

By law, credit bureaus are authorized to disclose information from their files to any person or organization with a legitimate business need for the information in connection with a transaction involving the consumer.

Many experts recommend that you check out your credit record. You can do this by writing the credit bureaus and requesting a copy of your file. If you have been denied credit in the last 30 days you may request a copy of your credit file for free.

Most of the information in your credit file may only be reported for 7 years. If you have declared personal bankruptcy, however, that fact may be reported for 10 years. After 7 years or 10 years, the information in your credit file can't be disclosed by a credit reporting agency unless you are being investigated for a credit application of $50,000 or more, for an application to purchase life insurance of $50,000 or more, or for employment at an annual salary of $20,000 or more.

Incorrect Information in Your Credit File - Credit bureaus are required to follow reasonable procedures to ensure that subscribing creditors report information accurately. However, mistakes may occur. Your file may contain erroneous data or records of someone with a similar name. When you notify the credit bureau that you dispute the accuracy of information, it must reinvestigate and modify or remove inaccurate data. You should give the credit bureau any pertinent data you have concerning an error. If reinvestigation does not resolve the dispute to your satisfaction, you may place a statement of 100 words or less in your file, explaining why you think the record is inaccurate. You may also want to place a statement in your file to explain a period of delinquency caused by some unexpected hardship, such as serious illness, a catastrophe, or unemployment, that cut off or drastically reduced your income. The credit bureau must include your statement about disputed data or a coded version of that statement with any report it issues about you.

(HANDOUT - WHERE TO OBTAIN COPIES OF YOUR CREDIT REPORTS)

VI. How Much Credit Can You Handle?

A. Long-Standing Rules

If your monthly payments on debts, excluding your home mortgage payment, exceeds 20 percent of your after-tax or take-home pay, you most likely have reached your credit-debt limit.

Indications that you are heading toward or have already reached your credit-debt limit are any of the following:

- Making minimum payment on your account
- Using credit for expenses you normally paid cash for
- You have consolidated loans in order to pay bills
- Cannot save money
- Borrowing from one lender to pay another
- You are denied credit

B. Determine Your Credit Ceiling

(HANDOUT - DETERMINING YOUR CREDIT CEILING)

This calculation gives you the maximum amount that is available to you.

(HANDOUT - DEBT-TO-INCOME RATIO)

This calculation gives an accurate view of the total debt burden of an individual or family by comparing the dollars spent on gross annual debt repayments, including mortgages, to gross income.

VII. Government Credit Cards

Statistics show that 70 percent of the persons who are 90 days or more delinquent are delinquent due to ATM cash withdrawals. Since American Express took over the Department of Defense (DoD) charge card program, it has issued more than 262,000 cards to Air Force members. By mid-November of 1993, Air Force members-military and civilian- were $13.2 million delinquent on payments.

A. Avoid Problems Using the Government American Express

Call the American Express customer service number 1-800-492-4922 to request a personal identification number (PIN) when you receive your card.

Use your card for all official TDYs of 30 days or less.

Official use of this credit card is limited to authorized travel expenses such as plane tickets and rental cars, accommodations such as billeting and hotel rooms, meals and cash advances to cover TDY needs like per diem and taxi.

Use your card for any TDY where you will have access to a full-service finance and accounting office that can file a voucher at the end of each 30-day period. This will allow you to make your American Express payment.

Use your card for any official expense that the government will reimburse you for that is related to a "do-it-yourself" move.

- Any use of the government American Express card for a non-official purpose is illegal even if the cardholder pays the bill on time. If you are not TDY, DO NOT carry the card with you.

- A good rule to follow is: If you can't claim the expense on a travel voucher, you can't use the government American Express card to pay for it.

- What can't you use the "credit" card for? Everything else. That includes personal travel, cash advances for personal use, retail purchases, mail order purchases, car repairs, Christmas gifts, gambling, or anything else that you can't claim on your travel voucher.

B. Penalties for Abuse of the Government American Express

The penalties for misuse of the government American Express card are swift and sure. In ascending order, the member may receive:

- Letter of reprimand
- Unfavorable information file
- Control roster
- Article 15
- Administrative discharge
- Court-martial for dereliction of duty
- Failure to obey a lawful order
- Failure to pay a just debt

Each cardholder is individually liable. If they fail to pay American Express will seek civil action. American Express has the right to report negative activities to credit bureaus. Misusing a card may impact your credit rating. Considering how easy it is to get caught and how severe the penalties are, nothing is worth the risk of misusing the government American Express card.

REVIEW & SUMMATION

1. Review main points.

2. Answer any questions.

3. Distribute critques.

This lesson plan developed by Thomas Day, Travis AFB CA.

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DETERMINING YOUR CREDIT CEILING

A. INCOME

YOUR TAKE-HOME PAY ______________

SPOUSE'S TAKE-HOME PAY ______________

OTHER INCOME ______________

____

TOTAL ______________

B. MONTHLY EXPENDITURES:

FOOD ______________

RENT OR MORTGAGE PAYMENTS ______________

UTILITIES ______________

TELEPHONE ______________

INSURANCE (CAR, LIFE, MEDICAL) ______________

OTHER ______________

TOTAL ______________

C. MONTHLY PAYMENTS ON YOUR CURRENT DEBTS:

PERSONAL LOANS ______________

CHARGE ACCOUNTS AND OTHER CREDIT PAYMENTS ______________

____

TOTAL ______________

D. ANNUAL EXPENSES:

TAXES ______________

INSURANCE (NOT PAID MONTHLY) ______________

MEDICAL AND DENTAL BILLS ______________

SCHOOL COSTS ______________

CLOTHING ______________

ENTERTAINMENT ______________

VACATION ______________

OTHER ______________

____

____

ANNUAL TOTAL ______________

MONTHLY TOTAL (divide by 12) ______________

E. MONTHLY INCOME AVAILABLE FOR SAVINGS OR CREDIT PAYMENTS:
A - (B + C + D) = E ______________

This calculation gives you the maximum amount that is available to you. These funds could be used for new credit spending or for savings. A rule of thumb is that an emergency fund in the form of savings or other readily accessible assets should equal three to five months of after-tax income. That means that if your after-tax income is $1000 per month, you should have from $3000 to $5000 available in savings or in another form that could easily be converted into cash.

WHERE YOU CAN OBTAIN COPIES OF YOUR CREDIT REPORTS

Check your credit history every one to three years. If you apply and are denied credit, you have the right under federal law to a free copy of your credit report. You must request the report within 30 days of denial. Some bureaus will provide the report free within 60 days of denial. If you want to have the fees waived because you were recently denied credit, include a copy of the denial letter.

- *Equifax* - You may order a copy of your credit report by calling 1-800-685-1111. Or, write to: Equifax, P.O. Box 740241, Atlanta, GA 30374-0241. Be sure to include your full name, address, Social Security number, date of birth, and daytime telephone number. To fax your request, simply dial 1-404-612-2668. The cost is $8.

- *Trans Union* - Call Trans Union at (216) 779-7200. Or, write to Trans Union Corporation at P.O. Box 7000, North Olmsted, OH 44070. You'll need to provide the following information: your full name (spouse's name if applicable), your current address, your previous address if you've moved in the past two years, your Social Security number, your spouse's Social Security number (if applicable), date of birth, current employment, signature, and telephone number. The cost is $15.

- *TRW* - This agency will provide you with one *free* copy of your credit report each year. To obtain a copy, call 1-800-392-1122. Or, write to TRW at P.O. Box 2350, Chatsworth, CA 91313.

- A consolidated report of the information collected by the major bureaus can be ordered by contacting: Confidential Credit File, Credco, 2141 Palomar Airport Road, Suite 200, Carlsbad, CA 92009. Or, phone 1-800-443-9342. The cost is $25.95.

THE HIGH COST OF BORROWING

The actual cost of taking out loans varies widely according to the type of loan and the source of the money. In the table below different types of loans are listed in order of their cost to consumers. Study the sources of low-cost credit and avoid high-cost loans if possible.

Low-Cost Loans -- In Order of Cost

- From employers, friends and relatives
- On insurance policies
- Secured loans such as passbook loans from banks
- Federal and state-subsidized education loans
- Personal loans from banks
- Unsecured personal loans from credit unions
- First mortgage loans from savings institutions
- Loans for new cars from thrift institutions
- Unsecured personal loans from thrift institutions
- Second mortgage loans from bank holding original mortgage

Moderate-Cost Loans -- In Order of Cost

- Subsidized education loans to parents from banks
- Home-equity lines of credit
- Second mortgage loans from bank not holding original mortgage
- Second mortgage loans from finance companies
- Bank charge cards and credit lines

High-Cost Loans -- In Order of Cost

- Unsecured personal loans from finance companies
- Loans on used cars from banks, finance companies or automobile dealers
- Pawnbrokers' loans
- Loan sharks

INTEREST RATE BASICS

Simple interest is the dollar cost of borrowing money or receiving earnings from lending money. The interest is based on three elements:

- The dollar amount, called the *principal.*
- The *rate of interest.*
- The amount of *time.*

The formula for computing interest is

Interest = Principal x Rate of interest x Time (I = PRT)

The interest rate is stated as a percentage for a year. For example, you must convert 12 percent to either 0.12 or 2/100 before doing your calculations. The time element must also be converted to a decimal or fraction. For example, three months would be shown as either 0.25 of 1/4 year. Interest for 2 1/2 years would involve a time period of 2.5. A simple rule for changing between monthly and annual rates is: Divide the annual rate by 12 to find the equivalent monthly rate; multiply the monthly rate by 12 to find the equivalent annual rate.

Example - Change 15 % per year to the monthly rate and change 1.5 % per month to the annual rate.

15 % per year / 12 = 1.25 % per month.
1.5 % per month x 12 = 18 % per year

Example - Suppose $1,000 is borrowed at 5 percent and repaid in one payment at the end of the year. Using the simple interest calculation, the interest is $50, computed as follows:

$50 = $1,000 x 0.05 x 1 (year)

Example - $1,000 is borrowed for two months at 18 % per year. Calculate the simple interest on an annual and a monthly basis.

Annual: Rate -- 18 % per year; Time -- 2 months = 2/12 year

I = P x R x T = $1,000 x 0.18 per year x 2/12 year = $30

Monthly: Rate -- 18 % per year = 18 % / 12 = 1.5 % per month; Time -- 2 months

I = P x R x T = $1000 x 0.015 per month x 2 months = $30

DEBT-TO-INCOME RATIO

A **debt-to-income ratio** provides an incisive view of the total debt burden of an individual or family by comparing the dollars spent on gross annual debt repayments, including mortgages, to gross annual income. A ratio of 0.30 or lower indicates adequate gross income to easily make debt repayments, and it implies that one has some flexibility in budgeting for other expenses. This ratio should decrease as one grows older.

EXAMPLE

If a couple had $13,200 in annual loan repayments ($10,800 for a mortgage loan and $2,400 for an automobile loan), and their annual salary was $52,000, this would amount to 25.4 percent of their annual income.

Annual debt repayments / Gross annual income = Debt-to-income ratio

$13,200 / $52,000 = .254 or 25.4 percent