CREDIT & BORROWING

FINANCIAL LIT FOR TEENS

Member FDIC

WHAT IS A CREDIT SCORE?

A credit score is a number between 300–850 that depicts a consumer's creditworthiness. The higher the score, the better a borrower looks to potential lenders. A credit score is based on credit history: number of open accounts, total levels of debt, and repayment history, and other factors. Lenders use credit scores to evaluate the probability that an individual will repay loans in a timely manner.

How Credit Scores Work

A credit score can significantly affect your financial life. It plays a key role in a lender's decision to offer you credit. People with credit scores below 640, for example, are generally considered low. When a borrower needs to finance something, a low score could mean higher rates and shorter repayment terms. The borrower could also be required to have a co-signer.

Conversely, a credit score of 700 or above is generally considered good and may result in a borrower receiving a lower interest rate, which results in their paying less money in interest over the life of the loan. Scores greater than 800 are considered excellent.

A person’s credit score may also determine the size of an initial deposit required to obtain a smartphone, cable service or utilities, or to rent an apartment. And lenders frequently review borrowers' scores, especially when deciding whether to change an interest rate or credit limit on a credit card.

Score ranges:

- Excellent: 800 to 850
- Very Good: 740 to 799
- Good: 670 to 739
- Fair: 580 to 669
- Poor: 300 to 579

The main factors evaluated when calculating a credit score:

- Payment history
- Total amount owed
- Length of credit history
- Types of credit
- New credit

It's up to you, to make sure your credit remains strong so you can have access to more opportunities to borrow if you need to.

DISTINGUISHING BETWEEN CREDIT MYTHS AND REALITIES

There are many myths, misconceptions, and misinformation about financial topics. Learning to separate fact from fiction can help you make informed spending decisions.

MYTH OR REALITY?

1. Debt is the same as credit.

MYTH

Reason: Credit is the ability to borrow money, while debt results from using credit.

MYTH OR REALITY?

2. There is no such thing as good debt.

MYTH

Reason: Borrowing money to further your education with a certification, license, or a degree that can help you get a better-paying job can be an example of good debt if you finish your studies and your future income will support the amount that you borrow. Borrowing money to get a reliable car to get you to work might be another example of good debt if the loan terms fit your budget.

MYTH OR REALITY?

3. If you are worried about debt, you may have too much.

REALITY

Reason: One way to know if you have too much debt is if your debt causes you a lot of stress.

MYTH OR REALITY?

4. Co-signing a loan may affect your future ability to get a loan.

REALITY

Reason: A creditor may consider the increased amount of debt that you now have as a result of co-signing for a loan. If the main borrower does not pay, the default can show up on both the borrower's and the co-signer's credit records.

MYTH OR REALITY?

5. If a debt collector calls you about repayment of a debt, you have the right to tell him/her to stop calling you.

REALITY

Reason: The Fair Debt Collection Practices Act (FDCPA) gives you the right to tell the debt collector to stop contacting you. It does NOT cancel the debt that you owe. It also does not stop the debt collector from reporting nonpayment to the credit reporting agency or from suing you.

MYTH OR REALITY?

6. The majority of Americans who filed for bankruptcy due to medical debt had health insurance.

REALITY

Reason: Medical debt can pile up when someone becomes seriously ill or is injured. Even with health insurance, co-pays and deductibles can add up. This is one reason it's helpful to have emergency savings.

MYTH OR REALITY?

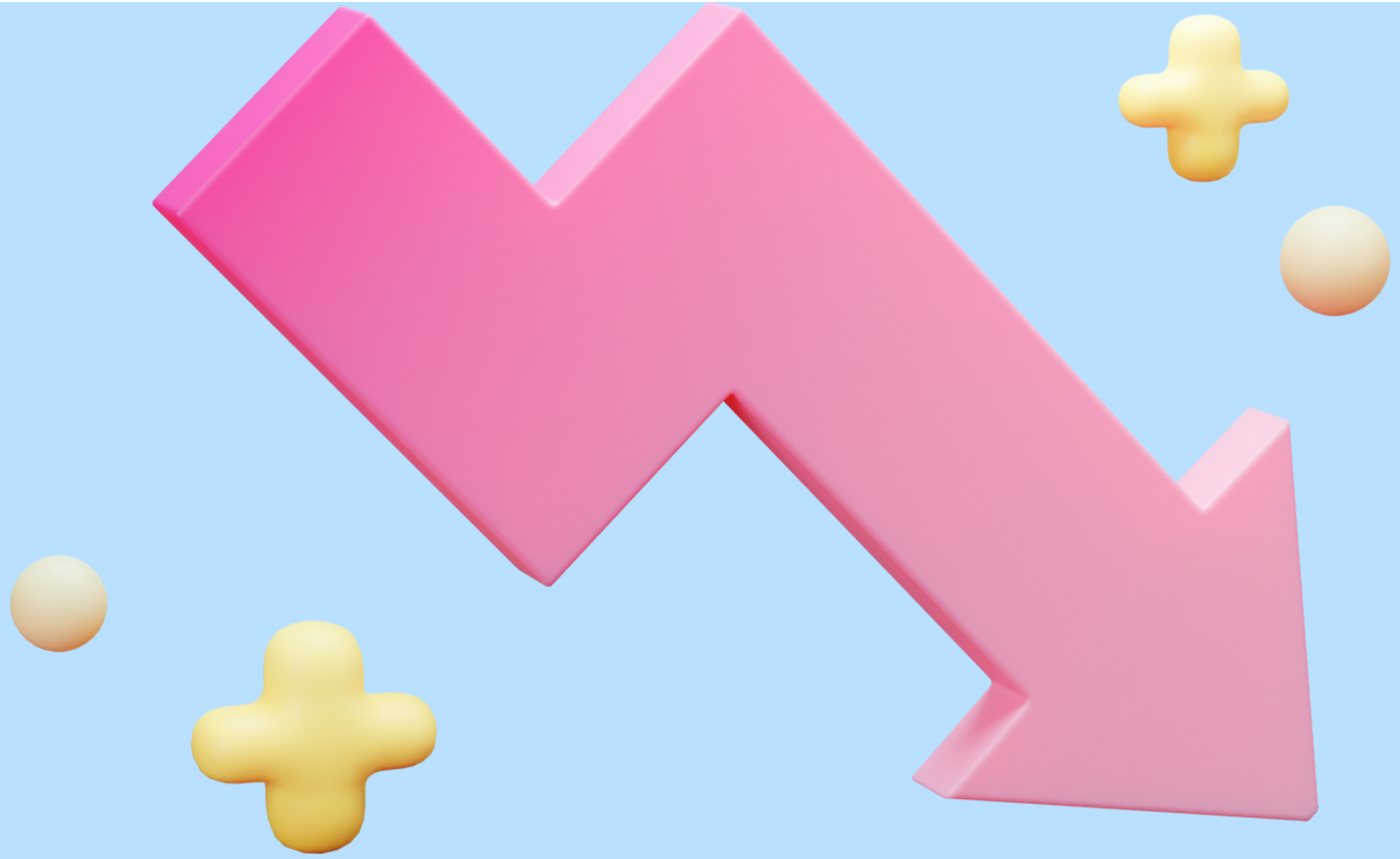
7. Information in your credit report is used to make a lot of decisions about you.

REALITY

Reason: An individual's credit report might be reviewed by a potential employer or to get security clearance for the military or a government job. It can be used by a landlord who is deciding whether to rent to the person, an insurer, a utility company deciding whether to impose a security deposit, and a lender deciding whether to issue a credit card and what interest rate to offer on the credit card.

MYTH OR REALITY?

8. Whenever you check your credit score, your score goes down a few points.



MYTH

Reason: You can get a copy of your credit report once each year for free from each of the three credit reporting agencies. The website is https://www.annualcreditreport.com/. Using this site will not affect your credit score.

MYTH OR REALITY?

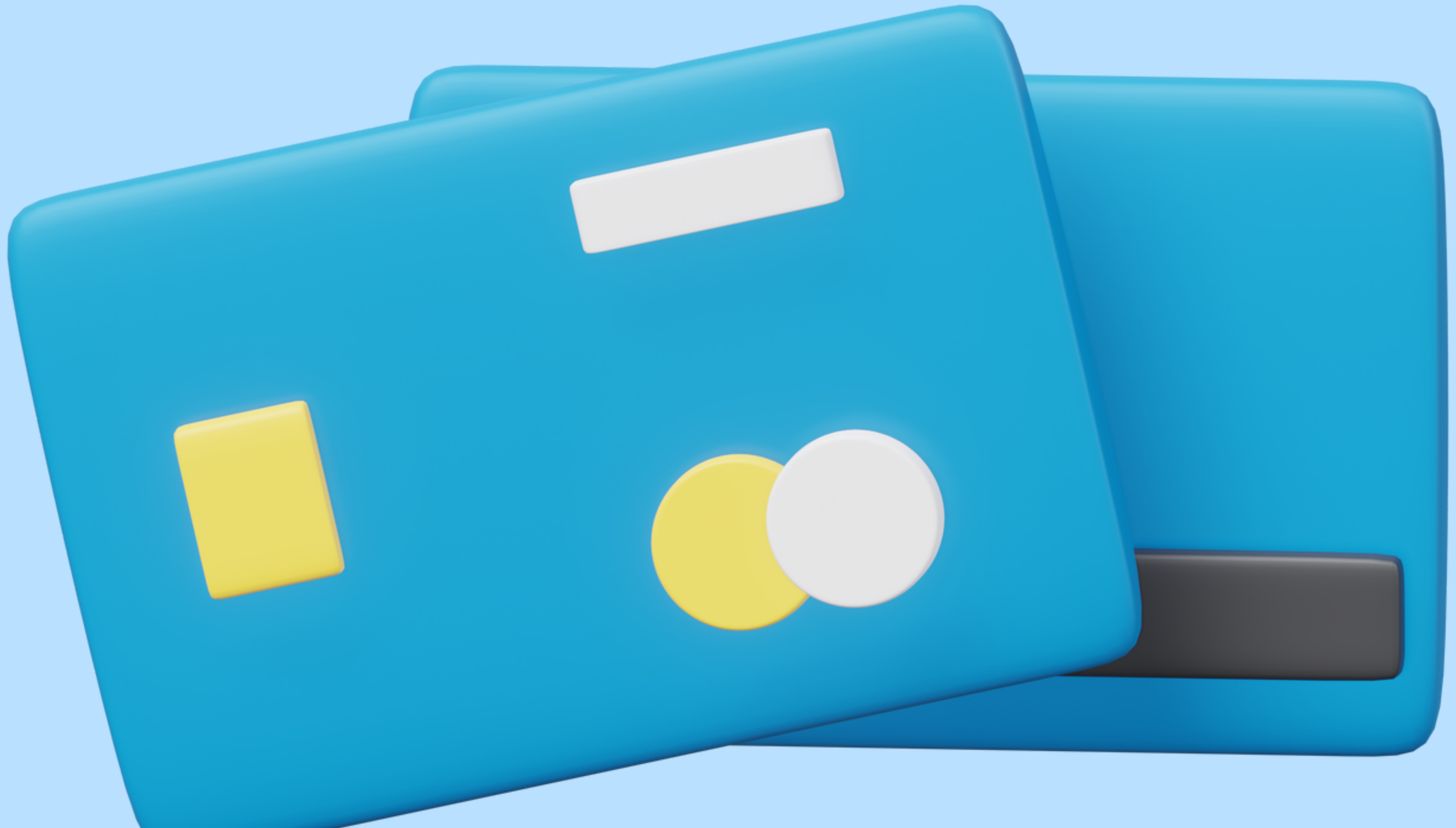
9. It's not uncommon for people to have more than one credit score.

REALITY

Reason: Different banks, credit card companies, and lenders may use different credit scores based on information from different credit reporting companies. These scores may differ from one another.

MYTH OR REALITY?

10. Always close credit card accounts that you do not regularly use; keeping them open hurts your credit score.



MYTH

Reason: If a person closes most of their credit card accounts and keep only one credit card open with a high balance on it that may end up hurting their credit score due to the high usage of available credit. It’s helpful to keep unused credit cards open to bring down the amount of your overall credit in use. But if you keep old cards open, keep an eye on them to be sure that an identity thief is not using them.

MYTH OR REALITY?

11. About one in 10 U.S. consumers (or 26 million people) are considered "credit invisible."

REALITY

Reason: People who do not have any credit record are considered “credit invisible.” Having a limited credit history can make it very difficult for a lender to get a credit score for an individual.

Capacity, Character, Collateral, Capital
THE FOUR CS OF CREDIT

CAPACITY

Capacity refers to your present and future ability to meet your payments. A lender wants to see that you have a job and you have held the same job or the same type of job for at least a year. Lenders may ask:

- Do you have a job?
- How much money do you make each month?
- What are your monthly expenses?

CHARACTER

Character refers to how you have paid your bills or debts in the past. Lenders may ask:

- Have you had credit in the past?
- How many credit accounts do you have?
- Have you ever filed for bankruptcy, had property repossessed, or made late payments?

COLLATERAL

Collateral refers to property or assets you can offer to secure the loan. Collateral is security you provide the lender. Giving the lender collateral means that you pledge an asset that you own (for example: a car) to the lender with the agreement that it will be the repayment source in case you cannot repay the loan. Lenders may ask:

- Do you have assets to secure the loan beyond your capacity to pay it off?

CAPITAL

Capital refers to the value of your assets and your net worth. Lenders want to determine the value of your assets (things you own that have financial value). Lenders will also compare the value of your assets and the amount of debt you have. This is called net worth. A positive net worth demonstrates your ability to manage your money. Lenders may ask:

- How much money do you have in your checking and savings accounts?
- Do you have investments (for example: stocks, bonds) or other assets (for example: a car)?

THE FOUR CS CHALLENGE

Lenders often determine an applicant's Four Cs during the loan application process.
The following information is taken from the Uniform Residential Loan Application, which is the standard form used for mortgage loan applications. The questions are similar to applications for other types of loans.

Review each section and match the required information with the appropriate C:
Capital, Collateral, Character, or Capacity. There may be more than one correct answer.

Capital
Collateral
Character
or Capacity

1. Employment Information: ______________________

Name & Address of Employer ☐ Self Employed	Dates (from – to)
	Monthly Income
Position/Title/Type of Business	Business Phone (incl. area code)
Name & Address of Employer ☐ Self Employed	Dates (from – to)
	Monthly Income
Position/Title/Type of Business	Business Phone (incl. area code)

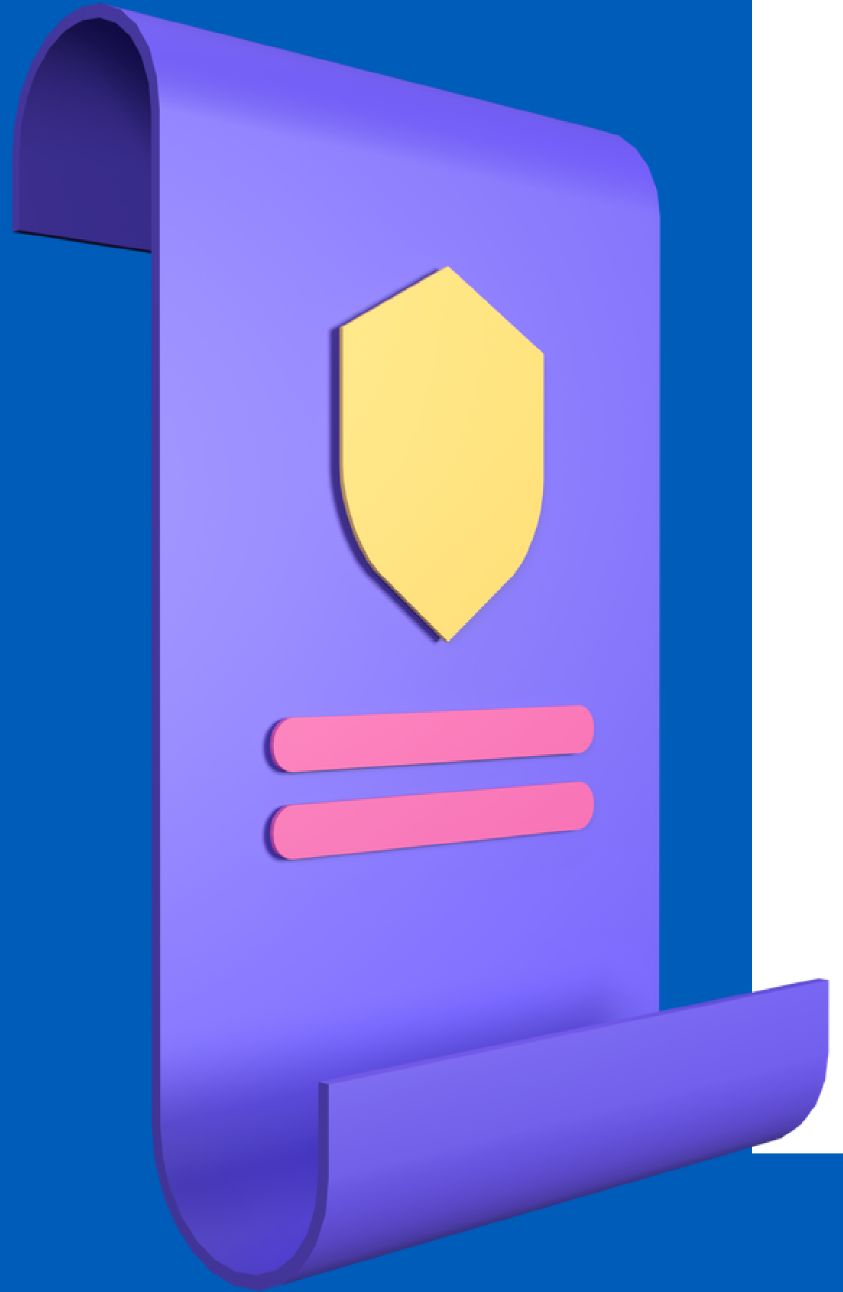
Capital
Collateral
Character
or Capacity

2. Monthly Income and Combined Housing Expense Information:

Gross Monthly	Borrower	Co-Borrower	Total
Base Empl. Income*	$	$	$
Overtime			
Bonuses			
Commissions			
Dividends/Interest			
Net Rental Income			
Other) before completing, see the notice in "describe other income," below"			
Total	$	$	$

Combined Monthly Housing Expense	Borrower	Co-Borrower
Rent	$	$
First Mortgage (P&I)		
Other Financing (P&I)		
Hazard Insurance		
Real Estate Taxes		
Mortgage Insurance		
Homeowner Assn.		
Dues Other		
Total	$	$

Capital
Collateral
Character
or Capacity



3. Declarations: ____________________

DECLARATIONS

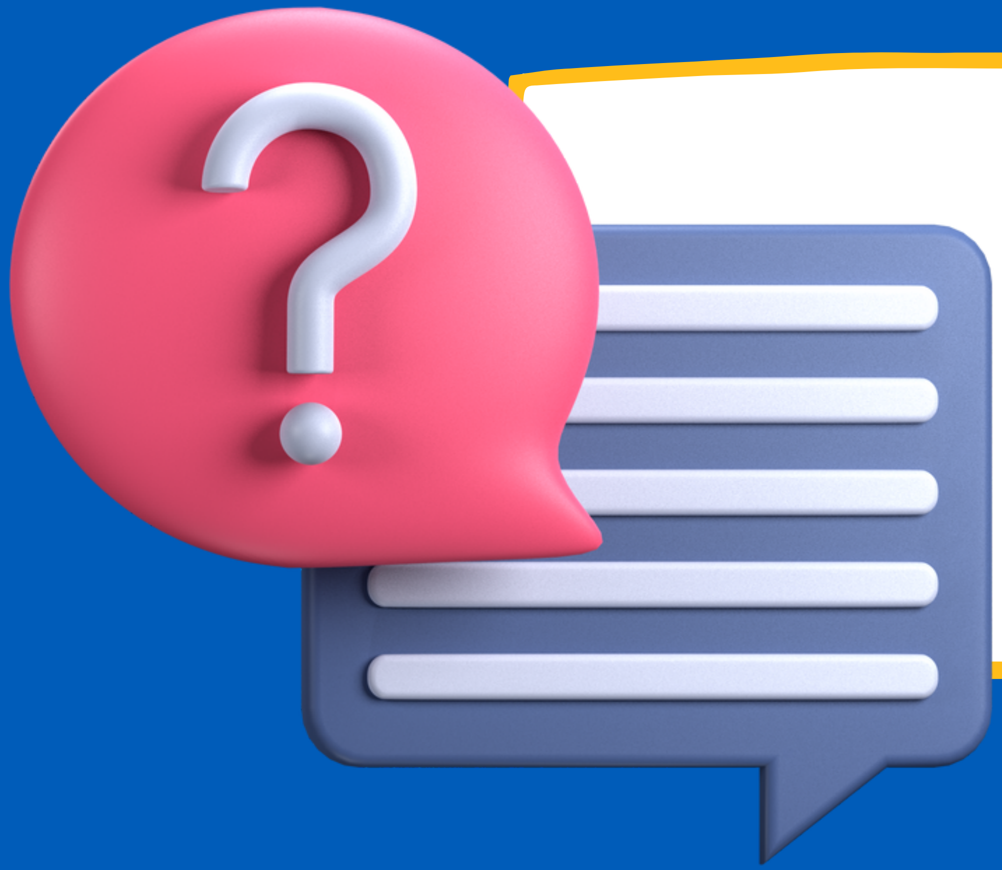
If you answer "Yes" to any questions a through e, please use continuation sheet for explanation.	Borrower Yes	Borrower No	Co-Borrower Yes	Co-Borrower No
a) Are there any outstanding judgments against you?	☐	☐	☐	☐
b) Have you been declared bankrupt within the past 7 years?	☐	☐	☐	☐
c) Have you had property foreclosed upon or given title or deed in lieu thereof in the last 7 years?	☐	☐	☐	☐
d) Are you a party to a lawsuit?	☐	☐	☐	☐
e) Have you directly or indirectly been obligated on any loan which resulted in foreclosure, transfer of title in lieu of foreclosure, or judgment?	☐	☐	☐	☐
(This would include such loans as home mortgage loans, SBA loans, home improvement loans, educational loans, manufactured (mobile) home loans, any mortgage, financial obligation, bond, or loan guarantee. If "Yes," provide details, including date, name, and address of Lender, FHA or VA case number, if any, and reasons for the action.)				

4. **Assets** (for example: checking and savings account, investment products, and vehicle) and **Liabilities** (for example: automobile or other loans, charge accounts, and other forms of debt): ______

Assets Description	**Cash or Market Value**	**Liabilities and Pledged Assets.** List the creditor's name, address, and account number for all outstanding debts, including automobile loans, revolving charge accounts, real estate loans, alimony, child support, stock pledges, etc. Use continuation sheet, if necessary. Indicate by (*) those liabilities, which will be satisfied upon sale of real estate owned or upon refinancing of the subject property.
Cash deposit toward purchase held by:	$	

List checking and savings accounts below	**LIABILITIES**	**Monthly Payment & Months Left to Pay**	**Unpaid Balance**
Name and address of Bank, S&L, or Credit Union Acct. no. $	Name and address of Acct. no.	$ Payment/Months	$
Name and address of Bank, S&L, or Credit Union Acct. no. $	Name and address of Acct. no.	$ Payment/Months	$

Capital
Collateral
Character
or Capacity



THE FOUR C's CHALLENGE ANSWERS

1. Employment Information: **Capacity**
2. Monthly Income and Combined Housing Expense Information: **Capacity**
3. Declarations: **Character**
4. Assets (for example: checking and savings account, investment products, and vehicle) and Liabilities (for example: automobile or other loans, charge accounts, and other forms of debt): **Capital and Collateral**

MANAGE OR DAMAGE

Read the scenario below and decide if the person's actions are managing or damaging credit.
Select the correct answer and explain your reasons.

Eli, 22 years old "I researched three different credit card options before I decided to get one about a year ago. I use it mostly to buy bigger items. Like last week I bought a new microwave for my apartment and put it on my credit card. I get a bill at the end of every month and then I'll go online and pay it in full. I don't want to have to worry about the credit card adding up to more than I have so I just think it's easier to pay it off every month."

MANAGE OR DAMAGE? WHY?

MANAGE OR DAMAGE

Read the scenario below and decide if the person's actions are managing or damaging credit. Select the correct answer and explain your reasons.

Imani, 18 years old "I bought a new cell phone after getting a job at the movie theater on the weekends. At first, I made all of my payments on time. But I ended up having to quit my job because I was having trouble in school and needed more time to study and get my homework done. I haven't been able to pay my phone bill on time for the last three months. I signed a two-year contract for my phone because the phone company gave me a discount if I did, but now I don't know if I can make it the full two years."

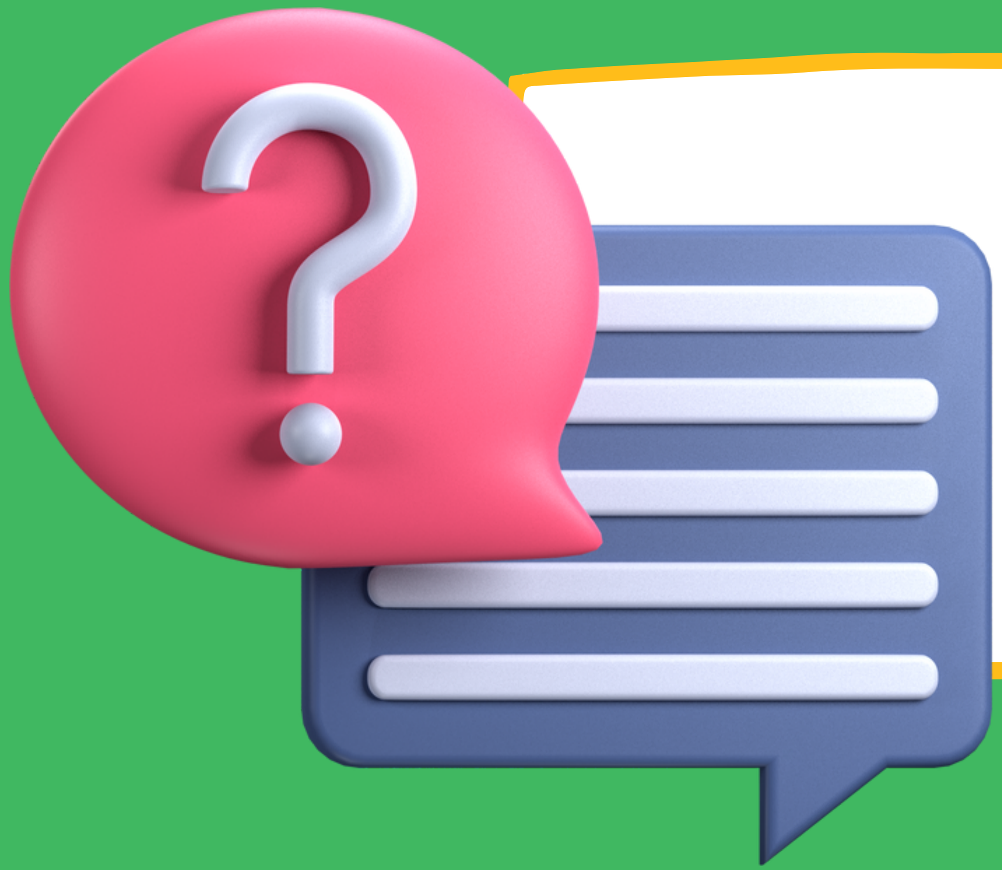
MANAGE OR DAMAGE?   WHY?

MANAGE OR DAMAGE

Read the scenario below and decide if the person's actions are managing or damaging credit. Select the correct answer and explain your reasons.

Ethan, 19 years old "When I started college last year, I couldn't believe how many credit card applications were offered to me. I thought, hey, why not? I'm going to need money for books and food and probably a football game or two, so I went ahead and applied for them all...and got approved! Now, all my cards are maxed out and I can't use them anymore because I've hit my credit limit. I let a few of the payments slip last month because I didn't have the money, but I'm thinking if I can get a new card then I can get more money to pay off my other ones."

MANAGE OR DAMAGE? WHY?



MANAGE OR DAMAGE ANSWERS

Eli's Scenario: MANAGE

Eli pays attention to what he uses his credit card for and pays the bill in full at the end of every month.

Imani's Scenario: DAMAGE

Imani did not think long-term when she committed to a two-year contract. As a result, she is unable to meet her repayment responsibilities.

Ethan's Scenario: DAMAGE

Ethan failed to realize that, just because credit was available to him, he didn't need to use it all. He overextended himself and is considering going even deeper in debt to pay off his existing debt.

FINANCIAL RATIOS

WHO CAN RECITE THE EXACT RATIO OF A CIRCLE'S CIRCUMFERENCE TO ITS DIAMETER, OR PI.

ANYONE?

Remember, even if a math challenge seems overwhelming at first, if we break the challenge into manageable pieces it becomes more workable.

Let's explore and practice financial ratios. And, if at first the ratios seem complex, by learning a few basic computing strategies, it can be much easier than memorizing “pi”!

FINANCIAL RATIOS

Lenders take a risk in lending money because there is always the chance that a borrower will be unable to repay the loan. To minimize risk and ensure a borrower is equipped to repay debt, lenders analyze and consider many different components before deciding to lend money to a borrower, including financial ratios.

DEBT-TO-INCOME

MONTHLY DEBT DIVIDED BY MONTHLY GROSS INCOME

Debt-to-Income measures your monthly debt payments against your monthly gross income.

To calculate, you divide your monthly debt by your monthly gross income.

For example: if you pay $200 each month for a vehicle loan and $1,000 each month for a home loan, your total debt payment each month is $1,200 ($200 + $1,000).

If your monthly gross income is $4,000, then your debt-to-income ratio is 30 percent ($1,200 ÷ $4,000).

A high debt-to-income ratio signals to lenders that a borrower may struggle to meet monthly repayments.

DEBT-TO-ASSETS

LIABILITIES DIVIDED BY ASSETS

Debt-to-Assets measures the amount of money owed (liabilities like a vehicle loan or student loan) to items that are of value (assets like property owned, savings accounts, retirement savings).

To calculate, you divide your total liabilities by your total assets.

For example: if you own a home that is worth $200,000 (asset), but you have a mortgage of $50,000 left on the home (liability), your debt-to-asset ratio is 25 percent ($50,000 ÷ $200,000 = 0.25 or 25%). The higher the percentage, the greater the level of risk.

DEBT-TO-LIMIT

CREDIT DEBT DIVIDED BY CREDIT LIMIT

Debt-to-Limit measures the amount of credit debt to your credit limit.

To calculate, divide your total credit card balance by the credit limit available to you.

For example: if you currently have a balance of $500 on a credit card with a credit limit of $3,000, your debt-to-limit ratio is 16 percent ($500 ÷ $3,000 = 0.16 or 16%).

Your debt-to-limit ratio, also called credit utilization, is used to calculate your credit score. The debt-to-limit should be at least 30 percent of the credit card limit, and not exceed 50 percent of the limit.

DEBT-TO-INCOME:
MONTHLY DEBT DIVIDED BY MONTHLY GROSS INCOME

Ishaan has a monthly mortgage payment of $800, one credit card at $200 a month, a second credit card at $80 a month, and a vehicle loan for $250 a month. His income is $2,500 each month before taxes.

What is Ishaan’s total debt?
What is his income?
What is his Debt-to-Income ratio?

DEBT-TO-ASSETS:
LIABILITIES DIVIDED BY ASSETS

Stephanie recently took out a loan for $5,500 to help pay for a new-used vehicle. The vehicle is worth $9,500.

How much are Stephanie’s total liabilities?
How much are her assets?
What is her Debt-to-Assets ratio?

DEBT-TO-LIMITS:
CREDIT DEBT DIVIDED BY CREDIT LIMIT

Avni has a credit card with a $5,000 credit limit. She currently has a balance of $2,000 on the card.

What is Avni's credit limit?
What is her debt?
What is her Debt-to-Limits ratio?

FINANCIAL RATIOS ANSWERS

What is Ishaan's total debt? $1,330
What is his gross income? $2,500
What is his debt-to-income ratio? 53%

How much are Stephanie's total liabilities? $5,500
How much are her assets? $9,500
What is her debt-to-assets ratio? 57%

What is Avni's credit limit? $5,000
What is her debt? $2,000
What is her debt-to-limits ratio? 40%

GROUP ACTIVITY

Be the first team to correctly solve the financial ratio problems on the next page.

Remember — the financial ratios to choose from are:

- **DEBT-TO-INCOME**
- **DEBT-TO-ASSETS**
- **DEBT-TO-LIMITS**

When your team is finished: Put all your pens down and all of your hands up!

Ready, set, race!

ready, set, race

James, 18 years old:
"I bought my first truck last year and it's great. It's so much easier to get to school and work now. I did have to borrow money, though, because I only had $3,000 saved up and the truck cost $5,000. I just checked online to see how much my truck is worth today, and it's dropped a little in value. If I sold it right now, it's worth $4,500. I still have $1,500 left on my loan, though. I'm wondering how I can measure my loan to the value of my truck. What do you think...which ratio should I calculate?"

What ratio should be used? What is the ratio percentage?

Elizabeth, 28 years old:
"I haven't been very good about managing my debt, and I'm trying to figure out how my debt relates to my income. I have four different credit cards right now but I really want to pay them all off soon. For now, though, I'm making monthly payments of $50 on one, $200 on another, $25 on a third, and $175 on the fourth. I also own a home, and my mortgage is another $900 a month. I earn $3,200 each month before taxes. Can you help me figure out what financial ratio to use?"

What ratio should be used? What is the ratio percentage?

Michael, 23 years old:
"I want to purchase a home someday, so I'm making sure my credit score is in good shape. I have a credit card that I can spend up to $1,000 on but I only have a balance of $100. What financial ratio would help me? Do the math...what's my percentage?"

What ratio should be used? What is the ratio percentage?

RATIOS RACE ANSWERS

James, 18 years old
What ratio should James use? Debt-to-assets ratio
What is James's ratio percentage: 33%

Elizabeth, 28 years old
What ratio should Elizabeth use? Debt-to-income ratio
What is Elizabeth's ratio percentage: 42%

Michael, 23 years old
What ratio should Michael use? Debt-to-limits ratio
What is Michael's ratio percentage: 10%

FIRST SAVINGS BANK