

UNDERSTANDING CREDIT



INTRODUCTION

CREDIT IS AN ESSENTIAL PART OF PERSONAL FINANCE AND UNDERSTANDING HOW IT WORKS IS CRUCIAL FOR MANAGING YOUR MONEY EFFECTIVELY. FOR MANY UNDERPRIVILEGED ADULTS, NAVIGATING THE WORLD OF CREDIT CAN BE INTIMIDATING AND CONFUSING. THIS COMPREHENSIVE GUIDE WILL COVER EVERYTHING YOU NEED TO KNOW ABOUT CREDIT, FROM THE BASICS TO MORE ADVANCED CONCEPTS, IN A CLEAR AND EASY-TO-UNDERSTAND MANNER.

WHAT IS CREDIT AND HOW IT WORKS

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CREDIT IS ESSENTIALLY AN AGREEMENT WHERE A BORROWER RECEIVES SOMETHING OF VALUE NOW AND AGREES TO REPAY THE LENDER AT A LATER DATE, OFTEN WITH INTEREST. IT ALLOWS INDIVIDUALS TO PURCHASE GOODS OR SERVICES THEY CANNOT AFFORD UPFRONT, WITH THE PROMISE OF PAYING BACK OVER TIME.

HOW CREDIT WORKS

1. **BORROWING:** WHEN YOU USE CREDIT, YOU'RE BORROWING MONEY FROM A LENDER, SUCH AS A BANK OR CREDIT CARD COMPANY.
2. **INTEREST:** MOST FORMS OF CREDIT INVOLVE PAYING INTEREST, WHICH IS A PERCENTAGE OF THE AMOUNT BORROWED, CHARGED BY THE LENDER AS THE COST OF BORROWING MONEY.
3. **REPAYMENT:** YOU REPAY THE BORROWED AMOUNT (PLUS INTEREST) OVER A SET PERIOD.

EXAMPLE

SARAH NEEDS TO BUY A REFRIGERATOR BUT DOESN'T HAVE THE \$500 NEEDED. SHE USES HER CREDIT CARD TO PURCHASE THE REFRIGERATOR, AGREEING TO PAY BACK THE \$500 PLUS ANY INTEREST ACCRUED OVER TIME. IF THE CREDIT CARD HAS AN INTEREST RATE OF 18% PER YEAR AND SHE ONLY PAYS THE MINIMUM AMOUNT EACH MONTH, IT WILL TAKE HER MUCH LONGER AND COST MORE DUE TO THE INTEREST.



CREDIT SCORES AND REPORT

WHAT IS A CREDIT SCORE?

A CREDIT SCORE IS A NUMERICAL REPRESENTATION OF YOUR CREDITWORTHINESS. IT'S BASED ON YOUR CREDIT HISTORY AND HELPS LENDERS DETERMINE THE RISK OF LENDING YOU MONEY. SCORES TYPICALLY RANGE FROM 300 TO 850, WITH HIGHER SCORES INDICATING BETTER CREDITWORTHINESS.

HOW CREDIT SCORES ARE CALCULATED

CREDIT SCORES ARE CALCULATED BASED ON SEVERAL FACTORS:

1. PAYMENT HISTORY (35%): WHETHER YOU'VE PAID PAST CREDIT ACCOUNTS ON TIME.
2. AMOUNTS OWED (30%): THE TOTAL AMOUNT OF CREDIT AND LOANS YOU ARE USING COMPARED TO YOUR TOTAL CREDIT LIMIT.
3. LENGTH OF CREDIT HISTORY (15%): HOW LONG YOU HAVE BEEN USING CREDIT.
4. NEW CREDIT (10%): FREQUENCY OF NEW CREDIT INQUIRIES AND ACCOUNTS.
5. TYPES OF CREDIT USED (10%): THE VARIETY OF CREDIT ACCOUNTS YOU HAVE (E.G., CREDIT CARDS, MORTGAGES, LOANS).

EXAMPLE

JOHN HAS ALWAYS PAID HIS BILLS ON TIME AND KEEPS HIS CREDIT CARD BALANCES LOW. HE HAS A CREDIT SCORE OF 750, WHICH IS CONSIDERED VERY GOOD. THIS ALLOWS HIM TO GET APPROVED FOR A LOW-INTEREST LOAN WHEN HE NEEDS TO BUY A CAR.

WHAT IS A CREDIT REPORT?

A CREDIT REPORT IS A DETAILED RECORD OF YOUR CREDIT HISTORY. IT INCLUDES INFORMATION SUCH AS:

- PERSONAL INFORMATION (NAME, ADDRESS, SOCIAL SECURITY NUMBER)
- CREDIT ACCOUNTS (LOANS, CREDIT CARDS)
- PAYMENT HISTORY
- PUBLIC RECORDS (BANKRUPTCIES, LIENS)
- INQUIRIES (WHEN SOMEONE CHECKS YOUR CREDIT)

EXAMPLE

MARIA WANTS TO RENT AN APARTMENT. THE LANDLORD REQUESTS A CREDIT REPORT TO CHECK HER CREDIT HISTORY. HER CREDIT REPORT SHOWS THAT SHE HAS CONSISTENTLY PAID HER CREDIT CARD BILLS ON TIME AND HAS A FEW LOANS THAT SHE'S MANAGING WELL. THIS HELPS HER GET APPROVED FOR THE APARTMENT.



CREDIT CARD VS DEBIT CARD

CREDIT CARD

A CREDIT CARD ALLOWS YOU TO BORROW MONEY FROM THE BANK UP TO A CERTAIN LIMIT TO MAKE PURCHASES OR WITHDRAW CASH. YOU ARE REQUIRED TO PAY BACK THE BORROWED AMOUNT PLUS ANY INTEREST.

PROS:

- BUILD CREDIT: USING A CREDIT CARD RESPONSIBLY HELPS BUILD YOUR CREDIT HISTORY.
- REWARDS: MANY CREDIT CARDS OFFER REWARDS SUCH AS CASH BACK, POINTS, OR TRAVEL MILES.
- FRAUD PROTECTION: CREDIT CARDS OFTEN OFFER BETTER PROTECTION AGAINST UNAUTHORIZED CHARGES.

CONS:

- DEBT RISK: IT'S EASY TO ACCUMULATE DEBT IF YOU'RE NOT CAREFUL.
- INTEREST CHARGES: IF YOU DON'T PAY YOUR BALANCE IN FULL EACH MONTH, YOU'LL INCUR INTEREST CHARGES.

EXAMPLE

LISA USES HER CREDIT CARD TO BUY GROCERIES AND PAYS OFF THE BALANCE IN FULL EACH MONTH. THIS HELPS HER BUILD A POSITIVE CREDIT HISTORY WHILE ALSO EARNING CASH BACK REWARDS ON HER PURCHASES.

DEBIT CARD

A DEBIT CARD IS LINKED DIRECTLY TO YOUR CHECKING ACCOUNT. WHEN YOU USE IT, MONEY IS IMMEDIATELY DEDUCTED FROM YOUR ACCOUNT.

PROS:

- NO DEBT: YOU CAN ONLY SPEND THE MONEY YOU HAVE, SO THERE'S NO RISK OF DEBT.
- NO INTEREST: THERE ARE NO INTEREST CHARGES SINCE YOU'RE USING YOUR OWN MONEY.

CONS:

- NO CREDIT BUILDING: USING A DEBIT CARD DOES NOT HELP BUILD YOUR CREDIT HISTORY.
- LIMITED PROTECTION: FRAUD PROTECTION MAY BE LESS COMPREHENSIVE COMPARED TO CREDIT CARDS.

EXAMPLE

TOM USES HIS DEBIT CARD TO PAY FOR HIS MORNING COFFEE. THE AMOUNT IS IMMEDIATELY DEDUCTED FROM HIS CHECKING ACCOUNT, ENSURING HE DOESN'T SPEND MORE THAN HE HAS.



BUILDING AND MAINTAINING CREDIT

STEPS TO BUILD GOOD CREDIT

1. PAY BILLS ON TIME: ALWAYS PAY AT LEAST THE MINIMUM AMOUNT DUE ON YOUR CREDIT ACCOUNTS.
2. KEEP BALANCES LOW: USE ONLY A SMALL PORTION OF YOUR AVAILABLE CREDIT LIMIT.
3. LIMIT NEW CREDIT APPLICATIONS: TOO MANY INQUIRIES CAN LOWER YOUR SCORE.
4. MONITOR YOUR CREDIT REPORT: CHECK FOR ERRORS AND REPORT ANY INACCURACIES TO THE CREDIT BUREAU.

EXAMPLE

EMMA HAS JUST RECEIVED HER FIRST CREDIT CARD. SHE MAKES A SMALL PURCHASE EACH MONTH AND PAYS OFF THE BALANCE IN FULL. SHE ALSO SETS UP AUTOMATIC PAYMENTS FOR HER STUDENT LOAN TO ENSURE SHE NEVER MISSES A PAYMENT. OVER TIME, HER CREDIT SCORE IMPROVES.

STRATEGIES TO MAINTAIN GOOD CREDIT

1. STAY WITHIN LIMITS: AVOID MAXING OUT YOUR CREDIT CARDS.
2. MANAGE DEBT WISELY: USE THE SNOWBALL OR AVALANCHE METHOD TO PAY DOWN DEBTS.
3. KEEP OLD ACCOUNTS OPEN: LONGER CREDIT HISTORIES CAN BOOST YOUR SCORE.
4. USE CREDIT RESPONSIBLY: ONLY BORROW WHAT YOU CAN AFFORD TO REPAY.

EXAMPLE

MIKE HAS MULTIPLE CREDIT CARDS BUT ENSURES HE NEVER USES MORE THAN 30% OF HIS CREDIT LIMIT ON ANY CARD. HE KEEPS HIS OLDEST CREDIT CARD OPEN, EVEN THOUGH HE DOESN'T USE IT OFTEN, TO BENEFIT FROM THE LONG CREDIT HISTORY.

CREDITS AND LOANS

CREDIT AND LOANS

TYPES OF CREDIT

1. INSTALLMENT CREDIT: LOANS THAT YOU REPAY WITH FIXED PAYMENTS OVER A SET PERIOD (E.G., PERSONAL LOANS, MORTGAGES).
2. REVOLVING CREDIT: CREDIT THAT ALLOWS YOU TO BORROW UP TO A CERTAIN LIMIT AND REPAY BASED ON HOW MUCH YOU BORROW (E.G., CREDIT CARDS).

EXAMPLE

JANE TAKES OUT A PERSONAL LOAN TO CONSOLIDATE HER DEBT. SHE HAS A FIXED MONTHLY PAYMENT FOR THREE YEARS. MEANWHILE, HER CREDIT CARD ALLOWS HER TO BORROW UP TO \$5,000 AND REPAY AS SHE USES IT.

UNDERSTANDING INTEREST RATES

INTEREST RATES ARE THE COST OF BORROWING MONEY, EXPRESSED AS A PERCENTAGE. THE LOWER THE INTEREST RATE, THE LESS YOU'LL PAY OVER TIME.

EXAMPLE

ALEX HAS TWO CREDIT CARDS. ONE HAS AN INTEREST RATE OF 15%, AND THE OTHER 25%. HE PRIORITIZES PAYING OFF THE CARD WITH THE 25% INTEREST RATE FIRST TO SAVE MONEY ON INTEREST CHARGES

PROTECTING YOUR CREDIT

AVOIDING IDENTITY THEFT

1. KEEP PERSONAL INFORMATION SAFE: DON'T SHARE YOUR SOCIAL SECURITY NUMBER OR CREDIT CARD DETAILS UNNECESSARILY.
2. MONITOR YOUR ACCOUNTS: REGULARLY CHECK YOUR BANK AND CREDIT CARD STATEMENTS FOR UNAUTHORIZED TRANSACTIONS.
3. USE STRONG PASSWORDS: PROTECT YOUR ONLINE ACCOUNTS WITH STRONG, UNIQUE PASSWORDS.

EXAMPLE

CARLA RECEIVES AN EMAIL ASKING FOR HER BANK ACCOUNT DETAILS. SHE DELETES IT, KNOWING IT'S A PHISHING ATTEMPT. SHE REGULARLY CHECKS HER CREDIT REPORT FOR ANY UNUSUAL ACTIVITY.

HANDLING CREDIT ISSUES

1. DISPUTE ERRORS: IF YOU FIND ERRORS ON YOUR CREDIT REPORT, CONTACT THE CREDIT BUREAU TO DISPUTE THEM.
2. SEEK HELP: IF YOU'RE STRUGGLING WITH DEBT, CONSIDER SPEAKING TO A FINANCIAL ADVISOR OR CREDIT COUNSELOR.

EXAMPLE

BRIAN FINDS AN INCORRECT LATE PAYMENT ON HIS CREDIT REPORT. HE CONTACTS THE CREDIT BUREAU AND PROVIDES EVIDENCE THAT HE PAID ON TIME. THE ERROR IS CORRECTED, AND HIS CREDIT SCORE IMPROVES.

CONCLUSION

UNDERSTANDING CREDIT IS FUNDAMENTAL TO MANAGING YOUR FINANCES EFFECTIVELY. BY KNOWING HOW CREDIT WORKS, MAINTAINING GOOD CREDIT HABITS, AND PROTECTING YOUR CREDIT, YOU CAN ACHIEVE FINANCIAL STABILITY AND REACH YOUR FINANCIAL GOALS. REMEMBER, THE KEY TO SUCCESSFUL CREDIT MANAGEMENT IS STAYING INFORMED, MAKING RESPONSIBLE DECISIONS, AND USING CREDIT WISELY.



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You!**

FROM: TARUSH