Personal Credit

April 26, 2021
What is “Credit”?  

**Merriam Webster**  
- Reliance on the truth or reality of something *or*  
- The provision of money, goods, or services with the expectation of future payment  

In practical finance terms, “credit” is a person’s ability to:  
(a) buy something (now)  and  (b) pay for it later or over time  

**Discussion Questions:**  
- Should you ever buy something that you can’t pay for in full now?  
  - Why might you do this / for what sorts of purchases?  

- What other benefits does the concept/use of “Credit” enable in modern society?  

- Flip the concept: if your best friend asked you for a $2,000 loan, would you give it to them? If so, what would you want to agree with them first?
Why is Your Credit important?

- **Landlords**
  - Credit “check” required for most rental applications

- **Credit Card Issuers**
  - How much credit capacity will they provide you?
  - What will your minimum monthly payment be?

- **Mortgage Lender or Auto Lender**
  - Can you afford to buy a particular home/car with a loan based on your income, assets and repayment schedule?
  - What will your interest rate (APR\(^1\)) be?

- **Insurers** (for car, home, etc.)
  - Insurance premium amount (monthly cost)

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(1) APR = “Annual Percentage Rate”
How is the Quality of your Credit determined?

The **Standardized Metric** used in finance is called a **FICO Score**\(^1\) which ranges from **300 to 850**

![FICO Credit Score Ranges Diagram](image)

**What Goes Into Your FICO Score?**
- Have you missed/been late on payments?
  - e.g., phone bill, car, credit cards
- How many open accounts do you have?
- How old are your open accounts?
- How much do you owe in total
  - Student loans, mortgage, credit cards…

**How can you improve your FICO score?**
- Don’t miss any payments, double/triple check your accounts!
- Avoid carrying credit card balances month to month
- Keep one old account (credit card) open even if you only rarely use it
- Keep your total debt load manageable vs. your income

\(^1\) FICO = named after the “Fair, Issac and Company,” which developed the score to assess consumer credit in the 1950s.
## Types of Personal Credit

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<th><strong>Open Credit</strong></th>
<th><strong>Installment Credit</strong></th>
<th><strong>Revolving Credit</strong></th>
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<td>(Gas, electric, water bills)</td>
<td>(Mortgages, student loans)</td>
<td>(Credit Cards)</td>
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**Open Credit**

- Must pay full amount monthly to avoid penalties
- No Interest rate

**Installment Credit**

- Fixed loan amount, meant for very large purchases/investments
- Fixed payments, usually over longer period of time (10-30 years)
- Exact time frame for payment

**Revolving Credit**

- Can continuously spend money up to a credit limit
- Monthly payments:
  - Can pay off any time
  - Minimum payment required each month
- Can carry a Debt Balance over month to month *but will pay high interest rate (20+%)*
## Factors To Consider When Choosing a Credit Card

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<th>Interest Rates</th>
<th>Reward Program</th>
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Before opening a credit card, ask yourself a few questions:

- What credit score is needed?
- How will I use the card?
- Why do I want to open the card?
- Is there an annual fee? Other fees?
- What is the interest rate?
- What is the repayment cycle?
## Dos and Don’ts of Credit Cards

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<th><strong>Dos</strong></th>
<th><strong>Don’ts</strong></th>
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<tr>
<td>• Be thoughtful about what credit limit you will need / use</td>
<td>• Open too many cards at once</td>
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<td>• Pay off your balance each cycle</td>
<td>• Carry balances across cycles</td>
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<td>• Compare cards before selecting</td>
<td>• Pick a card with high annual fees</td>
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<tr>
<td>• Look for cash back / other rewards and special offers</td>
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**Remember – you own the spending on your credit cards!**
Helpful Resources
More questions? Try the below websites / tools:
Questions?