Managing Your Family's Credit … A Consumers Guide
Michigan State University
Cooperative Extension Service
Home and Family Series
MSU Ag Facts
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July 1974
4 pages

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COOPERATIVE EXTENSION SERVICE
MSU FAMILY FACTS
No. 2

Extension Bulletin 488 — Home and Family Series

People once used credit only when they were in financial trouble. Now, going into debt is accepted as a normal money management practice. News articles tell us that use of consumer credit is necessary for a healthy U.S. economy. Advertisers promote credit sales in a way that tempts us. Public utility companies have trained us to buy telephone, electric and gas services under a use-now-and-pay-later plan. Retailers and lending agencies compete for our credit business. No wonder so many families use credit to buy many of the things they want or need. The problem is that many do not know how to use it wisely. This leaflet brings together some ideas on how to manage credit to your family's advantage.

CREDIT IS.................a means of getting money, goods and services now and paying for them in the future--a temporary substitute for cash. Using credit always means borrowing money, whether you take out a cash loan or charge something you buy. When you charge something, the dealer is really lending you all of the money to buy the product or service, and letting you pay back what you borrowed, plus any finance charge or interest, in regular payments over a certain period of time.

Consumer credit.......the kind we talk about in the leaflet .. is what families and individuals use for buying consumer goods and services. It is shorter term than home mortgage credit, usually for 36 months or less, and includes both credit sales and cash loans.

GOOD CREDIT MANAGEMENT PAYS OFF — It can help you reach some of your most important life goals and contribute to your community and the national economy. It can also help you avoid family crisis, badgering by creditors, loss of employment, and personal bankruptcy.

STEP UP TO GOOD MANAGEMENT — Once you have promised your future income for credit payments, you can't change your mind about spending it, so before making any credit decision, you and your family should take certain steps to make sure your decision is wise.

Step 1 Can You Afford Credit? — Decide whether you can safely add credit payments to your family's regular spending at this time. If you are already struggling to get everyday expenses like groceries and rent out of the paycheck, skipping credit payments now and then to leave enough for regular living expenses, or sometimes taking out new loans to pay for old ones, don't take on any new credit expense until you can pay off your present debts. The chart on P. 2 will help you figure how much credit your family can handle.

How much credit can you handle?

1. FILL IN:
The amount of take-home pay you can be sure of in the next year, not counting uncertain kinds of income like hoped-for raises or overtime pay. $________

2. SUBTRACT:
The amount you will need to spend during the year for day-to-day living costs, payments you have already promised to make regularly, and large, occasional expenses you expect, like fuel or winter clothes. -$________

THE ANSWER IS:
The amount you will have left to cover saving, emergencies, and possible credit payments. $________

3. SUBTRACT:
The amount you plan to save during the year to meet your family's goals for the future, such as special kinds of training, a big vacation trip, a house, retirement. -$________

THE ANSWER IS:
The amount you will have left for emergencies and possible credit payments. $________

4. SUBTRACT:
The amount you need to save for an emergency fund amounting to not less than one month's income nor more than three months' income. -$________

THE ANSWER IS:
The amount you have left for possible credit purchases. $________

Item 4. was included because you really can't afford to be without an emergency cushion if you are a credit user. Without it, an emergency could force you to miss a credit payment, have the item repossessed, and maybe still have to pay for it.

WARNING!
Danger
Ahead?

--The "amount left for possible credit purchases" must cover not only your new credit purchases, but also the costs of using them (maintenance, insurance, operating expenses).
--If you already owe close to 20% of your take-home pay on nonmortgage debts, you are near the top limit of debt that most families can carry safely, and this may be a good cut-off point for any new credit.
--For some families, new debts may lead to arguments, constant worry about paying off the debt, and sometimes even break-up of the family. Other families may take the debt right in stride. Which way is your family likely to react?

Step 2 **Should You Charge This Purchase?**

Consider whether the particular purchase you have in mind is the kind of item you should charge. If its useful life will be shorter than the time it takes to pay for it, you may not want to buy it on credit.

Step 3 **What's Your Best Cash Buy?**

Find the best cash buy. Shop for the best goods or service available in the price range your family can afford. Make sure the cash price quoted to you includes all tax, installation costs, etc. that you will have to pay the dealer.

Step 4 **What's The Best Credit Deal?**

Learn how much it would cost to buy this same item on credit. There are great differences in the cost of credit, depending on where you buy it and under what kind of credit plan. You will do well to shop around and compare prices on credit just as carefully as you do on shoes, cars, carpets, and appliances. Comparison shopping will help you find the least expensive credit plan available to you and suitable for your needs. Price both sales credit and cash credit (loans).

Who sells credit?

The usual suppliers of consumer credit are credit unions, banks, retail sales firms, consumer finance (small loan) companies, pawnshops and illegal lenders (loan sharks).

How do they set their rates?

- --The higher the risk to the lender, the more he charges for the credit he sells. (Of course, if your credit rating is poor, he may refuse to give you a loan at all.)
- --The cost of money the lender himself must borrow and his collection expenses, losses, and personnel costs are all included in your credit costs.
- --Michigan law sets different limits for each kind of credit deal.

How much can they legally charge?

The highest annual percentage rates allowed in Michigan are:

<u>Loans</u>	
Credit union loans	12.0%
Bank installment loans	12.7%
Small loans	21.8%-30.4%*
<u>Sales</u>	
New car sales contracts	10.9%-26.6%**
Used car sales contracts	16.2%-26.6%***
Home improvement financing	14.5%
Retail installment sales contracts	18.3%-21.5%**
Revolving charge accounts	20.4%

*Depending on amount of loan
**Depending on amount of sale
***Depending on model year and amount of sale

These are not flat rates which <u>must</u> be charged. Retail firms and lending agencies often charge less. Revolving charge accounts usually cost 18% instead of 20.4%, but are still more costly than credit union and bank installment loans.

What is the Annual Percentage Rate (APR)?

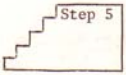
This is a basic rate that lets the credit buyer directly compare finance charges on all types of credit, even when the amounts of credit and repayment terms vary. The Federal "Truth in Lending" law of 1969 says this rate must always be used in quoting finance charges. It also says credit suppliers must figure the rate in one particular way. The method is quite complicated, but what it amounts to is dividing the dollar cost of the loan by the average amount of credit you get to use during the year. The answer is the annual percentage rate.

Insist on the APR

Some credit dealers disobey the law and quote a rate based on your having the use of the money for the full year, though in fact the balance gets smaller each month. If the quoted rate is 6 or 7 percent, most likely the true annual percentage rate is 12 or 14 percent, about twice that quoted. Always insist on being told the annual percentage rate! It is the reliable rate to use in comparing credit costs.

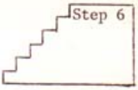
What credit terms should you compare?

- --Compare the annual percentage rates, but remember that if you can pay off revolving charge or loan accounts during the "free" period, there is no finance charge.
- --Choose the number and size of payments that will fit into your family spending plan without strain, but will pay off your debt as soon as possible. The larger the payments and the shorter the repayment time, the lower your total finance charge will be and the more money you will have left to use for something else.
- --On revolving charge accounts, look for the one that allows you the most days to repay without a finance charge.



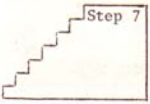
When You Apply For Credit

Take great care in applying for credit. Fill out the application form completely. Give honest answers and reveal <u>all</u> debts. Ask questions about anything you don't understand on the form.



When You Sign A Contract

If your credit application is accepted, a credit contract or agreement will be filled out for you to sign. <u>Don't rush into signing it</u>. Be sure you understand all of the contract and know exactly what you are promising. Read all of the fine print. It is just as binding as the larger print. If there is anything you don't understand, ask someone you trust <u>before you sign</u>. You can ask for a blank copy of the contract to take home and show to someone, or you can take someone along to read and explain the contract to you. The seller does not have to keep promises he makes to you unless they are written into the contract. Make sure he puts them in. If you don't agree with <u>all</u> of the terms, <u>do not sign</u>.



Keep Your Credit Rating Good!

Whether you can get credit and how much it will cost you depends on your credit rating, which is based primarily on your earning power and your past performance in paying off debts. If you can't pay on time, talk with your creditor.

Issued in furtherance of cooperative extension work in agriculture and home economics, acts of May 8, and June 30, 1914, in cooperation with the U.S. Department of Agriculture. Gordon E. Guyer, Director, Cooperative Extension Service, Michigan State University, E. Lansing, Michigan.

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