

Access Credit Basics 101

Where we are as a nation concerning Credit

When talking about credit it is important to understand that our nation is borrowing more than ever before, both as a nation and as households. During the generations following the depression and World War II most Americans only borrowed for large ticket items, such as a home and one car for the family. In recent times the accessibility of credit by lenders has prompted an explosion of growth for the economy, but also a new burden for many of the families who are unable to borrow responsibly.

Even more recently we have witnessed a host of foreclosures in many areas of the United States. In the end, growth that was spurred by the ease of access to credit has caused more distress than good for our nation.

So what's the answer?

Put simply the answer is to never spend what you cannot afford, and to also borrow responsibly. It is up to you to educate yourself on financial basics that will protect your family. First let's start with an explanation of how financial institutions work and what credit is.

How Financial Institutions Work...

In the most basic sense a financial institution takes money from depositors and pays them interest on those deposits. The financial institution then has to find a way to pay for the interest on those deposits, so they loan other people's money to qualified borrowers at a higher rate than the interest paid on deposits. The institution generates income from the difference, this is known as the spread.

What is Credit?

Credit is the level of confidence a lender has that a borrower will repay a loan. In most circumstances the more confident the lender is in the borrower's ability to repay, the lower the interest rate the borrower will receive. Inversely, the less confident the lender is in the borrower, the greater the risk, and thus the higher the interest rate.

Why use Credit?

Credit allows you to experience use of an item, before you own it outright. Most folks would be unable to afford a house or automobile if they were forced to pay cash.

What and What NOT to borrow for...

As mentioned borrowing for homes, autos, education, etc. are all practical reasons to utilize credit. As a general rule, you should not use credit for everyday expenses, such as groceries or gasoline.

How do I know if I can afford a monthly payment?

Borrowing should revolve around a household budget (if you don't have one- prepare one, or call the credit union and we can point you in the right direction). If you aren't sure you can afford a monthly loan payment, a good rule of thumb is to pay yourself for a period of time. Find out what the monthly payment would run you then setup a separate account. Each month on a specified date pay yourself the payment to the new account. If you find yourself getting into that account you probably cannot afford the loan. This is also a good method for saving a down payment on an auto loan.

What obtaining a loan really cost me?

As we have discussed lenders generally charge higher interest rates for riskier loans, so what does that really mean for the borrower. Let's look at this mortgage loan example. Suppose you borrowed \$100,000 for 30 years, well run the numbers at two different rates, both 6% and 8%. The outcome will probably shock you:

- **\$100,000 mortgage for 30 years at 6%**
 - **Total interest paid = \$115,922 (total cost of home \$215,922)**

- **\$100,000 mortgage for 30 years at 8%**
 - **Total interest paid = \$164,227 (total cost of home \$264,227)**

 - **Total Savings of \$48,305 by qualifying for the lower rate**

So how does it all work (how do I build my credit so I can qualify for the lowest rates)?

To begin establishing your credit you need a small manageable loan or small credit card account. Be careful, many consumers have good intentions to establish their credit and end up with a mess, actually worsening their overall financial situation.

Another key point is that cell phones and utility payments will generally not report satisfactory pay history to credit bureaus (they do report if you fail to pay your bill). So make sure that first small loan or card comes from a lender that reports to the credit bureau each month.

Remember, terms and conditions of different lenders can vary greatly, so you definitely need to review the interest rate, fees, and penalties that may apply. If you are not sure contact someone who has established credit and explain your situation. As always, comparison shopping is recommended.

A good rule of thumb is to not attain more than one credit card in a 6 month period, and once you have 3 cards in an 18 month period, you should stop acquiring cards for at least 6 to 12 months time. A host of new cards can make it look like you are accumulating new debt or the potential for new debt more rapidly than you should.

Another avenue of establishing credit is to have someone with an established credit history to cosign your initial loan or credit card. If a friend or relative does indeed co-sign a debt for you, this means the loan will report on their credit and they are dually responsible for the repayment. So be sure to manage this debt appropriately.

Finally, taking all of the above steps will help begin and establish your credit. Just remember, not taking care of your finances will adversely impact your credit. So follow some easy rules to build your credit. First, never miss a monthly payment. Second, always pay on or before the due date (attempt to pay credit cards before the due date- some cards consider you to be in default if you are one day late- causing you to pay a higher interest rates, and fees). Lastly, don't charge or borrow more than you can payoff each month.

How can I recover from past credit problems?

As is often the case in our lives, we tend to learn by making mistakes. For many Americans, this holds true in terms of their credit. The first thing you should understand about correcting your past or current credit problems is simple. You must change your daily habits. Ask yourself, how did I get to this point? What type of habits caused me to be unable to (or choose not) manage my money well? If you need help determining these answers call the credit union, we will examine your credit and point you in the right direction.

One crucial error that many people make is taking a temporary fix. Instead of correcting the problem (poor spending habits, impulsive decisions, failure to budget), they instead borrow more money and in the long run it worsens the problem. Sound familiar? Look at it this way, if you have an illness and you go to the doctor the goal is to cure the illness not one of the symptoms. Curing one of the symptoms will only land you back in the doctor's office. There are many plans and programs to aid you in your cause. If you are really serious about changing your financial life, the credit union recommends the following websites: <http://www.daveramsey.com>
<http://www.crown.org>

Another great start is to pull your own credit report at <https://www.annualcreditreport.com> If you need help understanding your report, contact us at: 806-353-9999 or 1-800-687-2990. We can spend a few minutes with you and help you determine a plan for paying or settling accounts in bad standing. Please understand that we can only point you in the right direction, unfortunately we cannot get involved in negotiations or settlement calls to help you recover.

Finally, it is crucial that you understand that the process of rebuilding credit will take time and sacrifice depending on the severity of your situation. First, you need to diagnose your individual situation. Next, you need a budget, and then you must find a way to change the small daily and weekly habits that will help control your budget. Does financial freedom sound good, for most Americans it sounds great. Remember, there is no financial situation that you cannot overcome, but it will take time and hard work to make a life changing impact. If you are interested in more information on helping your situation we highly recommend you to seek out the websites listed above. They are experts on this matter and hold the keys to success.