



# Understanding Credit

## What is Credit?

Credit is money that is generally extended to borrowers whose credit risks are low. Banks assess the risk/reward relationship when considering granting credit as well as the overall profitability of the account.

- There is usually a cost associated with borrowing money, which is called the interest.
- The amount and type of credit that lenders grant you is determined by whether or not you have proven yourself to be financially *trustworthy*.
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## Understanding Credit Risk:

Credit risk refers to the risk that a borrower will default on any type of debt by failing to make obligated payments. In evaluating whether, and on what terms, to grant credit, banks assess the risks against expected return.

## Pros and Cons of Credit

### PROS

Helpful for Emergencies

Its Convenient

Increased purchasing power

### CONS

Easy to loose track of budget

Credit = Temptation

Credit Costs \$\$\$

# Establishing Credit

In order to establish a credit history, you need to borrow money and pay it back over time. By making your payments on time, you'll begin to establish good credit history. Here are two ways to begin:

- 1) Apply for a retail store or gasoline credit card
  - a. They are usually easier to get than other types of credit. By making a few small purchases and then making timely payments each month, you'll start to build a credit history.
- 2) Apply for a major credit card with a secured credit limit
  - a. If you have less than perfect credit or no credit at all, you may still qualify for a major credit card. Here is how it works:
    - i. As collateral (security deposit) you put a certain amount of cash (say \$1,000) into a frozen bank account. The bank then issues you a credit card with a \$1,000 credit limit. Once you've established a track record of timely, monthly payments, the card issuer will generally wave the collateral and return the security deposit to you.
- 3) Be careful of prepaid credit cards
  - a. Your money may not be secure as compared to the standard credit cards

## The Credit Report and Score

### What is a Credit Report?

- Your credit report serves as your financial "report card". It documents your credit history. It is the most important factor that lenders consider when you apply to borrow money. The better the credit rating, the better the terms and lower interest rates tend to be.

### What is a credit score?

- Your credit score is a number, determined by a complex mathematical formula that takes the information on your credit report and ranks you along a scale. The most popular scoring scale is Fair Isaac and Company (FICO) which ranges from 300-850.
- The credit score suggests your level of risk to lenders:
  - A low credit score indicates higher risk
  - A high credit score indicates lower risk

### A Credit score is determined by the following:

- 35% Payment History
- 30% Amounts Owed
- 15% Length of Credit History
- 10% Types of Credit in Use

### Obtain your annual free credit report:

- Visit: [www.annualcreditreport.com](http://www.annualcreditreport.com)

