



CREDIT

Personal Finance Basics

What is Credit?

Credit provides an opportunity to buy now and pay over time. For the use of this convenient tool, lenders will charge interest that must be paid in addition to any money you may borrow. Credit is a privilege that is offered to you, based on evidence you provide to demonstrate that you will be able to repay what you borrow. A lender will require evidence about these characteristics when you apply for credit. Remember the 4 Cs of Credit.

1. **Character** – Your lender will look for signs of stability and reliability, such as confirmation of employment and proof of regular rent or mortgage payments.
2. **Collateral** – A lender may require that a loan be backed up by the value of your personal property, such as your house or your car.
3. **Capacity** – Lenders need to confirm that you can repay the amount of the original loan plus the interest on the loan. A steady job that provides dependable income ranks high in importance.
4. **Credit** – The amount of credit you already have outstanding and the history of timely payments will be reviewed by the lender. Information about your current or previous credit is listed on your credit report.

Types of Credit

1. **Secured Credit** – Secured credit is protected and backed by the value of your property (collateral). If you fail to repay a secured loan, the lender has the right to possess and sell the collateral to recover what is owed. Because the lender is protected, this type of loan usually carries a lower interest rate than unsecured credit.
 - a. Most loans are offered for fixed amounts and the loan amount is given to you in one lump sum.
 - b. The length of time you will be given to repay the loan is usually determined at the time the loan is given. This amount of time is called the “life” or term of the loan and is expressed in months for shorter-term loans (24, 36, 48, or 60 months) such as for a car loan, or years for longer-term loans (15-30 years) such as for mortgages.
 - c. Payments are normally set at a fixed amount for the “life” of the loan until the loan is repaid in full. Your payments will include interest charges plus part of the balance (principal) due.

2. **Unsecured Credit** – Unsecured credit is a loan not backed by collateral. The risk to the lender is higher because there is no way to recover a loss if the loan isn't repaid. Because it is riskier, the interest rate for an unsecured loan is usually higher than the rate for a secured loan. The most common type of unsecured credit is a credit card. In general, interest rates are higher for credit cards than for other loans. Credit card interest is not tax deductible.
 - a. A credit card comes with a credit limit. You may use this amount after a period of time, you may use it all at once, or you may choose to keep the credit as “buying power” to be available as needed.
 - b. Most credit cards offer a period of time (a grace period) when you may use the credit before interest is charged.
 - c. You may pay the full amount due at any time. If you do not pay the full amount, monthly payments (called a minimum monthly payment on your bill) are usually required, based on a percentage of the full amount.
 - d. You may pay more than the minimum payment due, which will reduce your remaining balance and lower the amount of interest you will be charged on your remaining balance.
 - e. If no payment is made by the due date, you will be charged a late fee.
 - f. Fees and interest rates vary widely. Some cards charge annual fees for the privilege of having the credit card or higher interest rates for special benefits and programs.

Lake Region Bank is a good place to start for a small loan. If you are not able to obtain credit in your name only, your banker may suggest that a relative or friend with a good credit history co-sign a loan agreement with you. The co-signer guarantees that they will repay the loan if you cannot.

Credit is a necessary tool in our economy. Using it responsibly is a critical part of managing your personal finances, and impacts many other aspects of your life. Learning how to manage credit can turn your dreams of financing further education or buying a home into a reality.

Remember these three important tips for using credit responsibly:

1. Borrow only what you need and what you can afford to repay.
2. Start small and perform as promised.
3. Repay loans and credit on time.

By utilizing this information, you will move toward achieving your personal financial goals. As you do, contact Lake Region Bank for guidance. The important thing is to get started right away – then watch your money grow and your dreams come true.