

LD  
5655  
A762  
No. 354-125  
c.2

## Lesson Five

# Managing Your MONEY

Publication 354-125

2000

Adapted by Constance Y. Kratzer and Amber Wilson\*

### How Much Credit Can I Afford ?

Consumer credit is a way of using future income to buy the goods and services you want today. When used wisely, credit can be a valuable financial tool. But when it is used carelessly, credit can cause serious financial problems.

Can you recognize the credit danger signals? Take a few minutes to answer these statements as they apply to you. Check ALL that apply to you.

- 1. Don't save money
- 2. Always out of money before payday
- 3. New monthly credit card charges are MORE than the monthly credit card payments that you make
- 4. Longer time needed to pay account balance
- 5. "Juggling" payments to creditors.
- 6. Borrowing to pay "fixed" costs such as insurance
- 7. Credit card "cash advances" used to pay everyday expenses
- 8. Receive creditors' calls and letters demanding payment of overdue bills
- 9. Unsure of how much you owe
- 10. Always late in paying bills

Now, total up the number of blanks you have checked.

- 1 check: Signals Caution
- 2 checks: Trouble Brewing
- 3 or more checks: You should be very concerned and need to take some steps now to help correct the problem.

### Advantages / Disadvantages of Credit

Borrowing money isn't good or bad in itself. It just depends on how you use it. When you use credit, what you are actually doing is paying to borrow someone else's money. It's up to you to pay back what you have borrowed by a certain date at a specified cost to you, usually the amount borrowed plus interest charges. Some advantages of credit are:

- Interest costs for some kinds of purchases may be deducted if you itemize deductions on your tax return. ( Check with your tax preparer—these deductions include interest on a home mortgage, home equity loans, and some educational loans.)
- During inflationary times, you repay a debt with cheaper dollars
- It is possible to buy some goods at a lower price now than in the future
- Credit cards are convenient to use and safer than carrying large amounts of cash
- Credit allows you to buy items you can't afford to pay for immediately

\*Extension Specialist and Extension Associate, respectively; Management, Housing and Consumer Education, Virginia Tech



VIRGINIA POLYTECHNIC INSTITUTE  
AND STATE UNIVERSITY

## Virginia Cooperative Extension

Virginia Cooperative Extension programs and employment are open to all, regardless of race, color, religion, sex, age, veteran status, national origin, disability, or political affiliation. An equal opportunity/affirmative action employer. Issued in furtherance of Cooperative Extension work, Virginia Polytechnic Institute and State University, Virginia State University, and the U.S. Department of Agriculture cooperating. J. David Barrett, Director, Virginia Cooperative Extension, Virginia Tech, Blacksburg; Lorenza W. Lyons, Administrator, 1890 Extension Program, Virginia State, Petersburg.



VIRGINIA STATE UNIVERSITY



Disadvantages are:

- You may be easily tempted to buy more than you really need because it's so simple to say, "charge it."
- Instead of comparison shopping for the best price, you shop at the store where you have credit.
- Buying on credit can be habit-forming and can add up to 20 percent or more to the cost of goods and services.
- Because you did not repay quickly, you actually end up paying more for an item you bought on sale than you would have had to pay when it was the regular price. Think about what you may have to give up later to pay for what you are getting now on credit. If you buy the stereo on credit now, what will you have to give up to repay the loan later? If you take a student loan, will your increase in income cover the cost of repaying the loan? Is it worth it to use credit?

### **Credit is Not Free**

The cost of credit depends on who you borrow from, your credit history, how much you borrow, and how long you take to repay the money you borrowed. Credit costs will vary from lender to lender. Before you borrow, compare the costs at several places. Use the worksheet on page 5 to compare rent-to-own, credit and cash purchases. APR (Annual Percentage Rate) can be used to compare costs. The higher the APR and the longer it takes to repay, the higher the total cost.

At a given interest rate, borrowing a smaller amount of money will result in a lower overall credit cost to you. So, a larger down payment lowers the total amount you will have to pay in finance charges.

The longer you take to repay your debt, the more you will pay. Don't just look at how much you have to repay each month. Look at the total amount of money you will repay. Be sure you know the cost of credit. Try to take the shortest repayment period you can, and make the highest monthly payments you can safely afford. Although repaying the debt in the shortest timeframe will save you money in interest charges, make sure that you are leaving enough money to cover current expenses. You do not want to create a situation in which you are stretching your cash flow too thin in order to repay a debt quickly.

### **Credit Worthiness**

Your credit history shows your ability and willingness to repay a debt. It is measured by your record of paying bills. It is determined by how

prompt and reliable you have been in making past credit payments. A good credit history helps you qualify for future credit and may also help you get credit at a lower cost. You can check your credit report through the three major credit reporting services. Please refer to the last worksheet in this lesson for an example of a credit file request form and the names, addresses, and websites of the credit reporting services.

You should also know that credit histories are used by insurance companies, not only to decide whether to give you coverage but also to decide whether to renew your coverage. In addition, insurance companies use this information to determine how much to charge for the coverage. They are often used by employers to check you out before you are hired or to decide whether to give you a promotion. Landlords also check them to decide whether to rent to you. So it's very important to keep a good credit history.

### **Can I Afford It ?**

Let's say you really want a new range—but you don't have the money for it—what do you do? Do you borrow the money? Or do you wait until you can save some money and buy it later? Consider these basic guidelines when thinking about borrowing money:

- Use the 15-20 percent rule. Your total debt load (except for your mortgage payment) should not exceed 15-20 percent of your monthly after-tax income.

Caution!!! This maximum may still be too high for some families, such as those with an uncertain job future or a low income, high rent or a high mortgage payment.

- Use the "Credit Signal Light" worksheet (included in this lesson). Write down how much money you bring home monthly. Multiply the amount by .20 for the maximum amount of credit you can afford. Compare this to your current monthly payments. Now decide—can you really afford to purchase that new range?
- How much credit you use is really a personal decision, but do look at your needs realistically. Credit is just one part of your spending plan. Consider carefully before obligating any of your future income. If you promise all your money to credit repayment, you won't have any money to "live on."

### **Getting Out of Trouble**

The best way to handle debts is to avoid them in the first place. But we all know that for the majority



of families this is very difficult to do. If you checked two or more of the statements at the beginning of this lesson, then it's time for you to do something to better manage your debt load.

If you did not complete the "How Much Do You Owe" worksheet in Lesson 2, use it with this lesson—

1. Make sure you know who you owe and how much you owe them. List each creditor (loan company, bank, department store, or family members), the total balance owed, the date the monthly payment is due, the number of payments left, the amount of the monthly payment, the due date, and any amount that is past due. Total the balance owed. Next, total your monthly payments.
2. Look for ways you might increase your income or decrease your spending. Try to free up some income so you can make your payments. You might want to re-read Lesson 3 for tips on reducing your spending leaks.
3. Do not use any more credit until you are in better financial shape. Try hiding those credit cards so you won't be tempted to use them. You may even need to cut them up! That is exactly what some budget counselors make their clients do before payments are adjusted.
4. If you see you will not be able to make your payments, by all means contact your creditors. **DO NOT IGNORE THEM!!** If you don't contact them about your financial difficulties, and don't make scheduled payments, your account may be turned over to an independent collection agency. However, many creditors, if they know the facts about your financial problems and are convinced of your intent to pay, may agree to defer payments or refinance the debt to reduce the size of your monthly payments. Many are willing to make some other kind of arrangement with you.

To be helpful, creditors must know of your problems **BEFORE** your payments are overdue. Avoiding them is the **WORST** thing you can do. Above all, **BE SURE TO KEEP YOUR WORD**. If creditors are willing to help you out, be sure you follow through as you say you will. Only make promises that you are sure you can keep.

5. Contact a credit counseling service for some help. Your local Extension office can provide you with some budget counseling advice and information, but is not able to mediate your payments with creditors.

## Avoid Credit Card Blues

It is all too easy to make purchases when you just have to pull out the "plastic." Easy that is, until all of the monthly bills arrive. Many families use credit to make ends meet and then find it hard, if not impossible, to make all the monthly payments. That's when the "credit card blues" set in. If you have trouble just meeting your monthly payments, let it be a warning to you to cut back on credit use. If you have a hard time avoiding impulse buying, leave the credit cards at home. Keeping track of what you charge is an idea that will help you keep out of trouble. One suggestion to help you keep track is to use a separate check register to record credit card charges. Those purchases add up at the end of the month without you realizing it.

Finding ways to reduce spending is hard for many families, but not impossible. Everyone in the family should be included in the cutbacks. The more involved the family is in planning ways to reduce spending, the more committed they will be to succeed. It also is a good lesson for your children to learn early in life.

## Be Credit Wise

Credit can be a friend or a foe. It can be an asset or a liability. If you abuse the privilege, it can ruin future plans. As your family's money manager, you have the responsibility to use credit wisely. If you find your debts have piled up and you feel as if you are out of control, develop a plan to help you solve the problem. Getting out of debt takes a lot of work and self-discipline. It can't be done overnight, but it can be done!

For more help, please feel free to contact your local Virginia Cooperative Extension office to request one of the following publications, or visit one of our websites at: <http://www.ext.vt.edu> or <http://www.ext.vt.edu/money2000/index.html>

- Getting Out Of Debt (VCE Publication 354-027)
- Talking with Creditors (VCE Publication 354-102)

*[Adapted with permission from Managing Your Money by Eleanor Ames, Ohio State University Extension]*

*This material is intended for educational purposes. It is provided with the understanding that the publisher is not engaged in rendering legal, accounting, or investment advice or services. If legal advice or other expert financial assistance is required, the services of a competent professional should be sought.*



## Decisions, Decisions: Save First, Buy Later? Rent-to-Own? Buy on Credit?

John and Mary want to get a color television with a remote control in time for Christmas. What should they do? Should they buy the TV on credit? Go to a "rent-to-own" store? Maybe they should wait until next Christmas and save the money each week to pay cash for a new TV. First, they must decide if they have a real "need" for the television, or if they just "want" a new TV.

Many people are attracted by the "rent to own" stores because they can satisfy their wants immediately. If you are thinking about making a major purchase, it is necessary to weigh the pro's and con's of each choice. Included here is a list of the options people would have in making such a purchase decision. Review these carefully. Then, when you are faced with this type of buying decision, you will be better prepared for the purchase.

Since rent-to-own stores have become very popular, here are some questions you will want to ask about their contracts BEFORE making a purchase.

- What is the total cost? Multiply payment amount times the number of payments.

- Does the company guarantee the item being rented is new?
- Can the customer buy the item outright at a reduced price at some point during the contract, or do they have to make all of the contracted payments to become the owner?
- Even though the company may provide repairs at no charge, does it also provide a substitute at no extra charge or stop payments during the repair period?
- Does the company require a large "balloon payment" at the end of the contract?
- If the renter misses one or more payments, can the RTO contract be reinstated without the customer losing the investment up to that point? Are there large penalties charged?
- Does the company require the renter to purchase insurance on the rented item, even though the customer may already have home or renter's insurance coverage?

## Rent-to-Own Compared to Credit and Cash Purchase

	RTO 78 Wks./18 Months to ownership	Credit Purchase 18 Months	Cash Purchase
Cash Price	\$331.76	—	\$319.00 Price + 12.76 Sales Tax \$331.76
Initial Payment/ Down Payment	First and last week's payment \$22.88	0% down-payment \$33.00	—
Installment Payment	\$11/wk. + 44 cents tax \$49.19/mo. <sup>1</sup>	\$19.49/mo.	—
Loan Payments Down Payment	\$11.44 X 78 = \$892.32	\$19.49 X 18 = \$350.82 + 33.00	—
Total Cost	\$892.32	\$383.82	\$331.76
"Extra \$" (above the purchase price)	\$560.56	\$52.11	—
Effective APR <sup>2</sup>	163%	21%	—

<sup>1</sup> The weekly payment should be multiplied by 4.3 weeks in a month, since assuming only 4 weeks per month would be equal to a 48-week year, thus concealing the cost of 4 weeks' payment.

<sup>2</sup> The customer could not figure out the APRs without a special calculator, but comparing the relative total dollar costs is dramatic enough. Adapted from Senior Consumer ALERT. American Association of Retired Persons, distributed by Sharon B. Seiling, Ph.D. Extension Specialist Family Resource Management, The Ohio State University.

## How Much Do You Owe ?

This worksheet will help you analyze your credit obligations. It is important for you to gather all of this information BEFORE you can begin developing a money management plan. Do not include mortgage payments. Complete all the blanks that apply. Include all loans and credit cards.

Company	Amount Still Owed	Due Date	Months Left to Pay	Monthly Payment	* APR	Amount Past Due

Total Amount Still Owed: \$ \_\_\_\_\_

*\*APR. Annual Percentage Rate*  
*Note: The average family should not commit more than 15% to 20% of its take-home pay to pay off consumer debts. If your family is larger, you may need to keep it even lower.*

To determine how much of your take-home pay goes toward consumer debt repayment, you need to calculate your Consumer Debt-Service Ratio.

$$\text{Consumer Debt-Service Ratio} = \frac{\text{Consumer Debt Repayment (monthly)}}{\text{Disposable income (monthly)}}$$

Consumer Debt equals monthly repayments for all non-mortgage consumer debts, including home-equity credit-line loans.

Take-home pay, sometimes called net pay or disposable income, is the income available after mandatory deductions for taxes and insurance. Irregular sources of earned or unearned income, such as interest earned or overtime earnings, are not included in disposable income for these calculations.



# Credit Signal Light

Total Monthly Take-Home Pay= \$ \_\_\_\_\_

Total Monthly Non-Mortgage Debt Owed= \$ \_\_\_\_\_

10% of Take-Home Pay = \$ \_\_\_\_\_

20% of Take-Home Pay = \$ \_\_\_\_\_

## **RED STOP!!**

Monthly Credit Payments take 20% or More of Take-Home pay. STOP!! Avoid More Credit.

## **YELLOW!**

Monthly credit payments take 15% of Take-Home Pay. CAUTION! Control New Credit Use.

## **GREEN**

Monthly credit payments take 10 - 15% of Take-Home Pay. Proceed Carefully!!

# Income & Payment Calendar

Accountants may be the only people who enjoy keeping records, but it's something you must do if you want to develop a workable money management plan. It doesn't have to be a burden if you try using this calendar. Duplicate the page and use it each month or just use your regular calendar. Fill in the dates you expect to receive income in GREEN; the dates when bills are due in RED and other important information such as CD's maturing, birthday expenses, etc., in OTHER COLORS. By using this calendar system you can see your finances in a specific time frame and plan ahead.

Month \_\_\_\_\_

Sunday	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday

# Credit File Request

To: \_\_\_\_\_

(Name of credit reporting agency you are requesting a file from)

**(Print or Type Only - Check Appropriate Boxes)**

\_\_\_\_\_ Please forward a copy of my personal credit file.

\_\_\_\_\_ Please forward a copy of our joint personal credit file.

\_\_\_\_\_ A check OR \_\_\_\_\_ a Money Order is enclosed to cover expense.

\_\_\_\_\_ I/we were **denied credit** within the past 30-60 days by: (name of firm)

\_\_\_\_\_ because of information in my/our credit files at your agency. (copy of letter enclosed) I/we understand a copy of my/our credit report will be sent without charge.

Date: \_\_\_\_\_ Daytime/message phone ( \_\_\_\_\_ ) \_\_\_\_\_

Full Name \_\_\_\_\_  
(as it appears on credit applications or accounts)

Current Address \_\_\_\_\_

Mail Address \_\_\_\_\_

City, State, Zip \_\_\_\_\_  
(P.O. Box etc., if different from street address)

Previous addresses (past 5 years) \_\_\_\_\_

Marital Status: \_\_\_\_\_ Spouse's/Partner's full name: \_\_\_\_\_

Date of birth \_\_\_/\_\_\_/\_\_\_ Spouse/Partner \_\_\_/\_\_\_/\_\_\_

Your Social Security # \_\_\_\_\_ - \_\_\_\_\_ - \_\_\_\_\_

Spouse's/Partner's Social Security # \_\_\_\_\_ - \_\_\_\_\_ - \_\_\_\_\_

\_\_\_ ENCLOSED is a photo-copy of my/our DRIVER'S LICENSE(s), or our UTILITY BILL or my/our MILITARY ID.

Signature(s): \_\_\_\_\_

Signature(s): \_\_\_\_\_

## Use these addresses to send in your credit file requests.

- Experian (Formerly known as TRW) PO Box 2104 Allen, TX 75013-2104 (fee: \$8 for single/\$16 joint) <http://www.experian.com>
- Trans Union Corporation Consumer Relations Center PO Box 390 Springfield, PA 19064-0390 (fee: \$8 for single/\$16 joint) <http://www.tuc.com>
- Equifax Credit Information Services PO Box 105873 Atlanta, GA 30348 (fee: \$8 for single/\$16 joint) <http://www.equifax.com>

Use these telephone numbers below to request your credit file if you have been denied credit within 60 days or IF you are going to pay for the report using a credit card.

Experian (TRW) 1-888-397-3742

Trans Union 1-800-888-4213

Equifax 1-800-685-1111