

Credit Rating (2.3)



In this section we will answer:

- How do I get a loan or credit card?
- Will I automatically get approved for a loan?
- How much can I Barrow?

Can I Barrow

Very often we find ourselves in situations where we might be in need of some help from others. Although it is not always easy to ask for help, our friends and family members do sometimes provide help by letting us barrow things. People barrow everything from money to a cup of sugar. However sometimes these acts of kindness lead to problems between friends and family. To keep this from happening may folks decide not to let anyone barrow anything or only allow borrowing if there are very clear rules and expectations. Today we are going to ask each other “Can I barrow...”

You will each receive a “Borrow card”. Once you have received your card and are directed to go, you will mingle with classmates to find someone who is willing to let the you borrow the item listed on your card. Although this is not real, you should act as if the deal is real. If you would not let someone barrow the item in real life, make sure you say no.

Reflection:

1. What were you trying to borrow?
2. Were you able to negotiate a deal to borrow the item? Why or why not?
3. What were the conditions (if any) for you to follow so you could borrow or use the item?
4. When you were asked to loan the item, what influenced your decision to let the person borrow the item?

Keeping Score with your credit

Mariah and her mom are visiting her community bank so Mariah can apply for a credit card. The bank's customer-service representative, Frank, explains that Mariah is not able to have her own credit card account because she is a minor. However, he hands over a credit card application and suggests that Mariah's mom consider opening the account with Mariah added as an authorized user or as a joint account holder

An **authorized user** is able to use the credit card account but is not legally liable for the balance due on the account.

Someone who is a **joint account holder** is equally responsible for the balance of the account along with the other person named on the account and is legally liable for any amount due.

Mariah watches as her mother completes the first section of the application, which asks for the following information:

- Full name
- Address and phone number
- Date of birth
- Social Security number
- Current employer
- Monthly income
- Bank name and account number
- Monthly rent or mortgage payment

While her mom fills out the application, Mariah asks Frank how the bank decides whom to approve. He explains that lenders may use credit scores or look at five key criteria known as the 5 C's of credit.

Conquer the 5 C's

Capital. You will need money to borrow money. Lenders appreciate when a borrower is able to cover some of the loan costs with existing cash on hand such as savings account or checking account funds. Having the ability to make a down payment or pay for closing costs may give the lender confidence that you can manage your funds to repay on time.

Frank notes that Mariah's mom owns a home and has a savings account.

Capacity. No one wants to loan money to someone who has no way to pay it back. So, lenders want to make sure you have more money coming in than going out. A history of

steady employment and increasing income makes them feel more confident about lending to you.

Frank points out that Mariah's mom has a good income and she has been with her employer for five years. It's also a plus that her mom's total debt is less than 20 percent of her income.

Character. Even wealthy people can be irresponsible with their money. That's why lenders request **credit reports** on applicants to see how they have used credit in the past. This is a way for lenders to check your reputation for repaying what you owe.

Mariah's mom has established a history of paying bills on time. Also, keeping her debt low over the past 10 years adds points in her favor.

Collateral. Lenders consider what possessions you can use for collateral to make loans less risky for them. If you don't pay, you may have to give the lender your collateral as partial compensation for what you owe. For example, your car might be identified as collateral when you sign an auto loan. But financial assets like a savings account may be used, too.

With credit cards, there's no collateral, so Frank will focus more on the other C's.

Conditions. Lenders may be more lenient about past credit troubles if you can prove you are moving past a bad experience—say, identity theft or unemployment—and you are making progress rebuilding a good credit history. They also will consider what's happening in the local economy and how this might affect your ability to repay a loan.

Fortunately, Frank says, current conditions are not an issue for Mariah or her mom, and her application is approved! Their cards with a \$300 account credit limit should come in the mail next week.

You make the call

It is time for you to take the power of the bank in your hands. In teams of three or four you will take the sample applications in the packet and review them. Your group must:

1. Establish criteria for approving (or denying) a credit application.
2. Decide whether to approve or deny each of the applications.

You must all have the notes. Make sure you pick one person to report back to the whole class.

APPLICATION		
Name		Social Security Number
Michael Carver		111-22-3333
Birth Date	Home Phone	Work Phone
1/1/88	702-###-####	
Current Address		
555 This Street, Boulder City, NV 89005		
Own or Rent?	Length of Time at Address	
Rent	Six years	
Mortgage or Rent Paid To	Monthly Payment	Outstanding Debt Amount
Mr. Landlord	\$695	about \$7000
Employment Income	Start Date	Employer Phone Number
\$ 2000 per month	January 11, 2006	702-###-####
Name and Address of Employer		
Candy Shoppe Main Street, Boulder City, NV 89005		
Other Income	Source of Other Income	Total Asset Amount
\$ 0 per month		\$ 4,309 (savings & car)
Reference/Other Creditors	Account Number	City and State
Boulder City Community Bank	555-56-031	Boulder City, NV
Requested Loan Amount	Purpose of Loan	
\$5,000	Purchase car	
Date	Signature	
	<i>Michael Carver</i>	

Decision: Approve Deny

Reasons:

1. _____
2. _____
3. _____

APPLICATION		
Name		Social Security Number
Carmen Vasquez		000-11-2222
Birth Date	Home Phone	Work Phone
11/24/96	720-###-####	
Current Address		
12 Money Street, Penny Town, CO 8111		
Own or Rent?	Length of Time at Address	
Live with parents	Entire Life	
Mortgage or Rent Paid To	Monthly Payment	Outstanding Debt Amount
		\$ 0
Employment Income	Start Date	Employer Phone Number
\$ 700 per month	January 15, 2011	303-###-####
Name and Address of Employer		
Susie's Gift Shop 123 Main Street, Penny Town, CO 81111		
Other Income	Source of Other Income	Total Asset Amount
\$ 75 - \$125 per month	Childcare as requested	\$1,745 (savings)
Reference/Other Creditors	Account Number	City and State
Colorado State Bank	123-45-678	Penny Town, CO 8111
Requested Loan Amount	Purpose of Loan	
\$5,000	Purchase car	
Date	Signature	
	<i>Carmen Vasquez</i>	

Decision: Approve Deny

Reasons:

1. _____
2. _____
3. _____

APPLICATION		
Name		Social Security Number
Victoria Mejia		987-12-3456
Birth Date	Home Phone	Work Phone
10/12/92	972-###-####	214-###-####
Current Address		
12 Apartment Road #514A, Dallas TX 75000		
Own or Rent?	Length of Time at Address	
Rent	1 year, 6 months	
Mortgage or Rent Paid To	Monthly Payment	Outstanding Debt Amount
Ms. Buck	\$390	\$ 2,615
Employment Income	Start Date	Employer Phone Number
\$ 39,520 per year	August 1, 2010	214-###-####
Name and Address of Employer		
Cable Company, 100 Main Street, Dallas TX 75000		
Other Income	Source of Other Income	Total Asset Amount
\$ 0 per month		\$ 3,381 (savings & car)
Reference/Other Creditors	Account Number	City and State
My Credit Union	2234567	Dallas TX
Requested Loan Amount	Purpose of Loan	
\$1,750	Professional toolkit	
Date	Signature	
	<i>Victoria Mejia</i>	

Decision: Approve Deny

Reasons:

1. _____
2. _____
3. _____

APPLICATION		
Name		Social Security Number
Jerome Charles		987-65-4321
Birth Date	Home Phone	Work Phone
7/15/96	222-###-####	
Current Address		
123 Apartment Place #1342, New York NY 10001		
Own or Rent?	Length of Time at Address	
Live with parents	3 years	
Mortgage or Rent Paid To	Monthly Payment	Outstanding Debt Amount
		\$ 193
Employment Income	Start Date	Employer Phone Number
\$ 400 per month		222-###-####
Name and Address of Employer		
Self employed (make jewelry and keychains)		
Other Income	Source of Other Income	Total Asset Amount
\$ 120 per month	Dog walking	\$ 0
Reference/Other Creditors	Account Number	City and State
Local Credit Union	1000101	NYC NY
Requested Loan Amount	Purpose of Loan	
\$1,499	Laptop	
Date	Signature	
	<i>Jerome Charles</i>	

Decision: Approve Deny

Reasons:

1. _____
2. _____
3. _____

Activity 2.8: Put your best foot forward

How creditworthy do YOU look to a lender?

Directions:

- Identify specific evidence to show how you meet any or all of the 5 C's of credit.
- If you don't have evidence now for any of categories, list what you will do in the near future so you can make a positive impression on a lender in that category.

C's of Credit	My Evidence
Capital	
Capacity	
Character	
Collateral	
Conditions	

Crack the code on credit reports

Would you want to loan money to someone who never pays you back? No! And you probably wouldn't want to loan it to someone who took forever to pay you back.

Lenders, too, don't want to loan money to people who aren't responsible about paying it back. However, if you have never done business with a lender, the lender will need to find a way to check out your borrowing reputation. Therefore, they turn to **credit reports**, which detail how a person has used credit in the past.

In other words, your credit report serves as your credit references. Credit reporting companies provide the service of updating your credit history so that the information is available for reference when you seek new borrowing sources.

The first time you apply for a credit card or loan in your own name as an adult, that lender will forward your information to credit reporting agencies. As you use credit, your file will eventually grow to include the following details:

- Where you live and work, recent past and present
- Loan amounts, credit limits, and balances on all of your credit accounts
- Whether you have been on time or late with payments
- If you have recent inquiries indicating that you may have taken on additional debt which has not yet been reported.
- Whether anyone's taken collection or legal action against you for your debts

Credit agencies then sell this information to lenders, apartment complexes, insurance companies, employers, and other businesses with a legitimate need to see how creditworthy you are.

That's a relief!

Federal student loans do NOT require a credit history, but more-expensive private student loans may.

Once you get a loan or credit card, any late payments or other missteps become part of your credit history. This can wreak havoc on your ability to borrow, as well as to get an apartment, a job, a cellphone, and more—for seven to 10 years.

Even if you get approved, your bad references can cause you to be charged higher interest rates or require a deposit payment before getting service.

Cosign Commitment

If you are unable to provide acceptable information for a lender to approve your credit or loan application, the lender might require someone to **cosign** on the agreement. A **cosigner** agrees to repay the debt if you don't and will need to be approved by the lender.

Before you agree to cosign for someone else, be sure you trust that person to use the credit responsibly, or you might be stuck making payments that aren't for things you want or even use. And that debt obligation and credit history will be part of your credit history, too.

Did You Know?

Debit cards and prepaid credit cards are not reported in your credit history. Using these cards cannot help you build credit references because no credit is offered through these types of cards.

Ace your credit score

On the way home, Mariah asks her mom how long a credit report is because Frank seemed to look hers over so fast.

Her mom explains that Frank probably just checked a **credit score**—a three-digit number based on the person's credit report. A credit report doesn't rate credit use, so credit scores tell lenders at a glance how likely someone is to be a responsible borrower.

When Mariah's mom recently purchased a credit score, it indicated that her credit history is in a low-risk category. This is likely what helped her get approved for the new credit card account.

But it took a lot of time and discipline for Mariah's mom to build a strong history that will score well. She fell behind on everything after college, which put her in a **subprime borrower** category—in short, someone lenders see as a big credit risk. And if they do let you borrow with a subprime score, they make you pay for it with high interest rates.

Because missed payments are removed from the credit report after seven years, they weren't factored into her mom's credit scores at all now. But seven years is a long time to pay for mistakes in borrowing!

A credit score is a short number with big power.

A great score can save you money by qualifying you for the best terms and interest rates. While it's not as good as cash sitting in the bank, it means that you are more likely to be able to borrow money if you ever urgently need it

On the other hand, bad credit scores or no credit history often has these downsides:

- More rejections for apartments, cellphone service, credit cards, and loans
- Large deposit payments when you start up service credit accounts for utilities
- Higher insurance payments for cars and other property coverage
- Much higher interest rates for any money you borrow—which can translate into thousands of extra dollars over a few years

Basically, having bad credit scores makes many aspects of your life more difficult and expensive. And rebuilding your creditworthiness can take years.

The credit grading scale

Many lenders choose to use scoring as a tool to help them predict if a borrower will repay what is owed and pay on time. The score gives a lender an indication of a borrower's creditworthiness based on credit history data.

The contents of your credit report at a specific time are used to calculate credit scores. As your history is updated and changed, your credit scores will be recalculated based on the current facts at that point in time.

What's a "good" score? That depends on the scoring model used by the lender to measure risk for a specific lending purpose, and, most importantly, what factors in the credit history most impacted that risk.

So, rather than focusing on a specific number, look at where your history falls in the range of risk and the factors that affected your score. If your scores are low, focus on what you need to change in the way you use credit. No matter which scoring model is used, your risk level and your risk factors will be fairly consistent.

Lay the foundation for good credit

Even if you don't need loans or credit right now, it's still worthwhile to build strong habits for the future. Start strengthening those responsible borrowing habits by:

- Returning items you borrow from friends, family, and the library—promptly and in good condition!
- Avoiding overdrafts in your checking and savings accounts—start by tracking all of your deposits and withdrawals (especially any debit card activity) and verifying your account activity regularly.
- Repaying yourself with interest if you borrow money from your savings account.
- Managing your cash flow so you rarely need to borrow money—don't be the friend who's always short when the bill comes!

Check your credit

When you begin to use credit, each of the three U.S. credit reporting agencies—Equifax, Experian, and TransUnion—compiles a report on you. It's smart to check these reports regularly to make sure there are no errors and no suspicious activity.

By law, you're entitled to one free copy of your credit report from each of these companies each year. (In other words, you can get a total of three free reports a year.) To get a credit report when you start using credit, just visit www.annualcreditreport.com or call 877-322-8228.