TIPS FOR SMARTER BORROWING

Credit is the use of someone else's money for a price, which is called interest. Other fees may also be charged. The use of credit creates debt, which is the outstanding balance owed to lenders. Debt repayment is a major expense for many families. Some people spend a day's pay (or more) per week repaying car loans, credit cards, and other debts. Not only is this expensive, but money that goes toward payments is unavailable for investing. Below are 24 tips for smarter borrowing.

1. **Borrow as little as possible by making the largest down payment you can afford (e.g., on a car).** When car payments end, continue making the previous monthly payment to yourself as a way to build savings for items such as your next car.

2. **Shop for the best credit deal, just as you would for other purchases.** Compare at least three credit issuers (e.g., banks) for the lowest APR and fees. Use the Credit Card Comparison Worksheet (Exercise I-12) on page 28 to compare three credit card offers.

3. **Separate borrowing decisions from purchasing decisions.** In other words, don't just accept the financing arrangement offered by a merchant (e.g., car dealer or furniture store). Shop around for better terms (e.g., through an employer credit union).

4. **Always pay more than the minimum monthly payment.** Otherwise, it could take years, even decades, to repay a loan. Even small amounts added to minimum payments produce awesome savings. For example, according to the book *Slash Your Debt*, send $25 a month more than the minimum on a 17% credit card with a $5,000 outstanding balance and you'll save $7,192 in interest and 352 payments (almost 30 years).

5. **Say no to credit life or disability insurance if you already have adequate individual or group policies.** If you don't currently have life or disability insurance and need it, shop around for the best buy in coverage.

6. **Avoid being "upside down" on a car loan.** This means that you owe more than a car is worth. Shorten the length of your car loan or make a larger down payment.

7. **Pay credit card bills promptly to reduce the average daily balance on which interest is charged.** Avoid cards using the two-cycle average daily balance calculation method. This method generally increases finance charges because it includes two billing cycle balances.

8. **Limit credit card cash advances.** The interest rate is high because most creditors charge interest from the date money is borrowed (i.e., there is usually no grace period), along with transaction fees (e.g., $2.50).

9. **Transfer balances on high-rate credit cards to those with low 6-month "teaser rates."** Try to payoff the balance before the low rate expires or seek another low-rate card. (Note: Doing this too frequently could lower your credit score.)

10. **Request a copy of your credit file.** By the end of 2005, residents of every state will be entitled to receive a free copy of their credit file each year from each of the major credit bureaus: Experian, Equifax, and Trans Union. Residents of other states are required to pay a small fee. Use the Credit File Request Form (Exercise I-13) on page 29 to make your request. Be sure to sign the form and include some type of identification such as a copy of your driver's license or a utility bill with your name and address. If there are errors in your credit file, contact the credit bureau promptly and request a correction.

11. **Request a copy of your credit score.** Credit scores are three-digit numbers that range from the 300s (worst) through the 800s (best). Lenders use them to assess a person's credit worthiness and to determine the interest rates charged for a loan or credit card. Credit scores are available online for a fee from each of the three major credit bureaus (www.experian.com, www.tuc.com, www.equifax.com) and www.myfico.com and for free from www.eloan.com.

12. **Complete the Credit Card Safety Record (Exercise I-14) on page 30, which includes spaces to list the issuers of your credit cards, the card user(s), the account number, and the telephone number and mailing address of the issuer.** Keep this form with your financial records in case a credit card is lost or stolen.

13. **Calculate your debt-to-income ratio by dividing the total monthly payment for household consumer debts into net (after-tax) household income.** For example, a family with a $250 car payment and $100 of monthly credit card payments and a $2,500 monthly net income would have a debt-to-income ratio of .14 ($350 divided by $2,500) or 14%. Financial experts generally recommend a debt-to-income ratio of no more than 15-20%. Above that, it is easy to become overextended and experience difficulty making payments. It is also recommended that consumer debt (e.g., credit cards, car loans, and student loans), plus housing costs (e.g., rent or mortgage payment), not exceed 40-50% of take-home pay.

14. **Consider alternatives to credit cards to reduce interest costs.** One example is using a home equity loan to consolidate high-interest credit card bills if you have the discipline not to run up credit card balances again. Interest on up to $100,000 of home equity debt is usually tax-deductible. Other lower cost sources of money are credit unions and loans against a 401(k) (note: certain limits apply) or cash value life insurance policy. Repay the loan promptly to protect your future financial security

15. **Avoid borrowing money from finance companies.** Apply at a bank or credit union first. Finance companies generally charge high interest rates and can be considered a negative reference in credit reports, thus lowering your credit score. This is because potential lenders may see this as an indication that you couldn't get a loan elsewhere due to prior problems.

16. **Consider closing less attractive credit card accounts so that you don't appear "credit heavy" to potential lenders.** Don't close your oldest accounts, however, because this could lower your credit score. Good candidates for closure are high-interest department store accounts and credit cards that charge high annual membership fees.

17. **Carry a list of credit card billing cycle dates with you when you shop.** This will help you select the card that provides the longest "float" time between the date of purchase and the date that payment is due.

18. **Select a credit card that best matches your debt repayment style.** If you generally make mini- mum or partial payments, look for a credit card with a low interest rate. If you pay your bill in full, seek a grace period and no (or a low) annual fee. A grace period is the number of days you have before a credit card company starts charging interest on new purchases.

19. **Design your own debt repayment schedule by paying more than the minimum amount required.** For example, repay a home equity loan over 3-5 years, not a bank's 15--20-year schedule. Another is a "do-it-yourself" biweekly mortgage. Simply divide your mortgage payment (principal and interest) by 12 and add that amount to each monthly payment. This has the same effect as a biweekly mortgage (i.e., 13 payments per year).

20. **Negotiate a discount from lenders, especially if you have a good credit history.** Many credit card issuers will reduce annual fees and/or interest rates upon request. Before calling, role play your request with a friend to sharpen your negotiating skills. If you have other credit cards or preapproved offers, hint that you will close your account or switch to another card issuer unless your request is honored.

21. **Read credit card disclosure charts and surrounding footnotes carefully.** By law, all credit card offers must include a so-called "Schumer Box" (named for the sponsor of the bill) that includes the APR, various fees, and the minimum finance charge.

22. **Complain if you get hit with an unjustified penalty (e.g., late fee).** Many creditors will reverse these charges upon request, at least for the first time. Also be aware that many creditors have decreased the amount of time between when a bill is mailed and when payment is due. As a result, there is a greater chance of a late fee being charged. In addition, some creditors have moved payment-posting deadlines to earlier times of the day, such as 10 a.m. This effectively means that the company must receive the payment by the day before for it to be posted on the due date. Check your bill inserts for details.

23. **Beware of credit traps.** These are products and features that can greatly increase the cost of borrowing. Examples include:

- late fees, which can be charged when payment is only a day late.
- over-the-limit fees charged for as long as a borrower's balance exceeds the credit limit.
- cash advances that charge interest immediately when a credit card is used to obtain cash.
- skip-a-month offers that allow borrowers to skip a payment but continue to accrue interest.
- rent-to-own agreements that allow consumers to rent items by the week for a stated time (often 78 weeks), resulting in a cost that is two to four times the amount it would cost to purchase an item outright.

- 125% equity loans that allow borrowers to receive loans greater than the value of their home, minus its outstanding mortgage. If you had to sell quickly; you'd be unlikely to get back all of what you owed. In addition, a portion of the loan would not be tax-deductible.

24. **Contact your local Cooperative Extension office for a PowerPay@ analysis.** This computer program helps users accelerate debt repayment by printing out a repayment calendar that adds monthly payments from paid-off debts (e.g., Sears credit card) to remaining debts (e.g., MasterCard), resulting in hundreds, even thousands, of dollars of interest savings.