



## All about credit

Credit plays an important role in our lives every day and at life's most significant moments. Whether you're a college student, a working professional, a parent or a widower, building and maintaining good credit is essential. Major purchases such as a house or a car, and even employment opportunities, can be dependent on a good credit history.

### What is credit?

Credit is borrowed money that you can use to purchase goods and services when you need them. You get credit from a credit grantor, whom you agree to pay back the amount you spent, plus applicable finance charges, at an agreed-upon time.

There are four types of credit:

- 1. Revolving credit.** With revolving credit, you are given a maximum credit limit, and you can make charges up to that limit. Each month, you carry a balance (or revolve the debt) and make a payment. Most credit cards are a form of revolving credit.
- 2. Charge cards.** While they often look like revolving credit cards and are used in the same way, charge accounts differ in that you must pay the total balance every month.
- 3. Service credit.** Your agreements with service providers are all credit arrangements. You receive electricity, cellular phone service, gym membership, etc., with the agreement that you will pay for them each month. Not all service accounts are reported in your credit history.
- 4. Installment credit.** With installment credit, a creditor loans you a specific amount of money, and you agree to repay the money and interest in regular installments of a fixed amount over a set period of time. Car loans and mortgages are two examples of installment credit.

### Why do you need credit?

Good credit is necessary if you plan to use credit to make a major purchase, such as a car or a home, or want to be able to take advantage of the convenience credit can provide. The importance of good credit also extends beyond purchases, in that it may be used by potential employers and landlords as part of the selection process.

Credit grantors review credit applications and credit reports to determine financial risk: If they lend you money, extend you credit or give you goods and services, will you pay them back? They may consider your income, how long you've lived at your present address, how long you've worked for the same employer, what kinds of assets you have and the balances of your bank accounts. Often, though, the primary resource guiding their decision is your credit history.

### How do you establish credit?

Getting your first line of credit can sometimes be challenging. If you don't have a credit history or if you have filed for bankruptcy in the past, credit grantors may be reluctant to extend you credit.

You can establish credit in three ways:

- 1. Start small and build up.** A local department store or bank is a good first step. Before you apply, ask the credit grantor if it regularly reports your bill-paying history to a credit reporting company, which will help you establish a history of responsible credit use.
- 2. Get a cosigner.** You can ask a parent, a family member or a friend with an established history of good credit to cosign a loan or credit card application for you. Make sure you pay as agreed, since you are putting your cosigner's good credit at risk.

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- 3. Apply for a secured credit card.** To obtain a secured credit card, you open and maintain a savings account as security for your line of credit, which is a percentage of your deposit.

If you're turned down for credit, ask the credit grantor for specific reasons. If your income is not high enough or you haven't lived at your current address long enough, you can reapply for credit when your situation changes.

After a few months of using your card and consistently paying your bills on time, you should apply for another card. Continue using your credit card, keeping your balances low and paying your bills on time. Before you know it, you won't have to ask for credit — grantors will come to you.

### How do you build good credit?

Your credit report acts as your financial references when you apply for new credit. The only way to build a good credit history is to use credit wisely.

Following are 10 tried and true tips for building credit:

- 1. Set a budget and live within it.** Credit should not be used to live beyond your means.
- 2. Provide complete, accurate and consistent identification on your credit applications.** This information helps set up your credit history correctly from the beginning, ensures that your new accounts will be matched to the correct report and minimizes the chance that your credit file will be incomplete.
- 3. Pay your bills on time.** Late payments, called delinquencies, negatively affect your ability to get credit since they indicate a stronger likelihood that you will make late payments again or will be unable to pay your debts in the future.
- 4. Have some credit, but not too much.** Having no credit history is almost as bad as having a negative credit history, and you only need a few accounts reported to the credit reporting companies to demonstrate credit management.
- 5. Have a mixture of credit types.** It is good to have a history of repaying an installment loan, but a revolving account demonstrates more clearly that you can responsibly manage credit.
- 6. Keep credit card balances low.** Keeping your balances low compared with credit limits shows that you aren't tempted to charge more than you can pay. By charging a small amount on at least one card and paying the balance on time, you will show that you can handle larger amounts of available credit.
- 7. Use caution when closing accounts.** Closing an account isn't always a good thing. It can result in an increase to your balance-to-limit ratio, making you appear to be an increased credit risk.
- 8. Be aware of your debt-to-income ratio.** Mortgage lenders consider your monthly payments compared with your monthly income.
- 9. Demonstrate stability.** Some creditors consider your length of employment, length of residence, whether you own or rent and if you have any savings in making credit decisions.
- 10. Contact your lenders if you fall behind on your payments.** Many lenders will work with you to set up a different payment schedule or interest rate.