

Credit – How Much Can You Afford?

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Financing Purchases

- Three ways to finance current purchases:
 - Money from savings
 - Present earnings
 - Borrow against future income
 - Trade offs are involved in using credit.

Credit Considerations

- Before you use credit for a major purchase, ask yourself some questions:
 - Could I pay cash or make a down payment?
 - Do I want to use savings for this purchase?
 - Does purchase fit with my goals and budget?
 - Could I use the credit I'll need in some better way?
 - Can I postpone this purchase?

Credit Considerations

Before you use credit for major purchases, ask yourself some questions:

- What are the opportunity costs of postponing this purchase?
- What are the dollar and psychological costs of using credit for this purchase?

CREDIT CONSIDERATIONS

- CREDIT CAN SERVE US – BUT – IT CAN ALSO MASTER US AND THE CHOICE IS OURS. IT DEPENDS UPON HOW WE USE IT.

Advantages of Credit

- Convenient
- Take advantage of sales
- Establish a good credit rating
- May get better service
- A method of forced savings
- A way to increase net worth
- If used wisely a hedge against inflation

Advantages of Consumer Credit

- Current use of goods and services
- Use for financial emergencies
- Safer than cash
- Can take advantage of float time
- May get rebates, airline miles or other bonuses
- Demonstrates financial stability
- Simplifies record keeping

Disadvantages of Consumer Credit

- Credit cost money
- Temptation to overspend
- Ties up future income
- Possible financial difficulties
- Potential loss of merchandise due to late or non-payment

Disadvantages of Consumer Credit

- Encourages impulse buying
- May cause you to be a poor planner
- May cause marriage problems
- Merchandise may cost more – by not shopping around
- Lost cards
- Loss of privacy

Measuring Your Credit Capacity

- Before you take out a loan, ask yourself...
 - Can I afford the loan?
 - What do I plan to give up in order to make this payment?
- Before cosigning a loan consider...
 - If the person doesn't pay, you will have to.
 - Can you afford to pay if the person does not?
 - It can affect your credit report.
 - Request that a copy of overdue payment notices be sent to you.

The 5 C's of Credit

- Creditors look for the 5 C's when evaluating an applicant for credit:
 - Character – Do you pay bills on time?
 - Capacity – Can you repay the loan?
 - Capital – What are your assets and net worth?
 - Collateral – What do you have of value that the lender can take if you don't repay?
 - Conditions – What economic conditions could affect your repayment of the loan?

How Much Credit Can You Afford?

- No two families spend their money the same way.
- No hard and fast rules.
- Five Guides

Guide 1

- 20% of disposal income
 - No more than 20% of disposal income for debt payment excluding home mortgage.
 - Example: \$2,000 per month take home pay (\$24,000 per year) = $.20 \times \$2,000 = \400 per month or \$4,800 per year.

Guide 2

- 10% of after tax income over an 18 month period.
- Example: \$24,000 = 12 months income
- \$12,000 = 6 months income
- \$36,000 = 18 months income
- x.10= \$360 per month of debt.

Guide 3

- One month's take home pay

Example: If take home pay is \$2,000 per month limit the total amount you owe on credit account minus auto and house payments to \$2,000 at any time.

Guide 4

- 1/3 of Discretionary income
 - Don't use more than one third of your yearly discretionary income for credit. Discretionary income is what you have left after paying all your necessary costs, such as housing, food, clothing, transportation, etc.
 - Example: Take home pay \$24,000 minus basic living cost \$18,000 = 6,000 divided by 3 = \$2,000.

Guide 5

- First 4 guides indicate a possible annual debt load of \$2,000 - \$4,800 per year excluding home mortgage.
- Guide 5 is the Balance Sheet Approach.
 - Income
 - Monthly spending (including savings, emergency fund and irregular expenses)

Managing Your Debts

- Notify creditors if you can't make a payment.
- Debt collection practices require that:
 - If a debt collector calls you, within five days they must send you a written notice of amount owed.
 - You can dispute the debt.
 - The debt collector has 30 days to verify the debt.

Reasons for Indebtedness

- Emotional problems such as the need for instant gratification.
- The use of money to punish.
- The expectation of instant comfort among couples who overuse the installment plan.
- Keeping up with the Joneses.
- Overindulgence of children.
- Lack of communication among family members.
- The amount of finance charges is too high.

Warning Signs of Debt Problems

- Paying only the minimum balance each month.
- Increasing the total balance due each month.
- Missing or alternating payments or paying late.
- Intentionally using overdraft protection or taking frequent cash advances.
- Using savings to pay routine bills such as food.
- Getting second or third payment notices.
- Not talking to your partner about money or talking only about money.
- Depending on overtime to meet routine expenses.

Warning Signs of Debt Problems

- Using up your savings.
- Borrowing money to pay old debts.
- Not knowing how much you owe.
- Going over your credit limit on credit cards.
- Having little or no savings for the unexpected.
- Being denied credit due to a credit report.
- Credit card revoked by the issuer.
- Putting off medical or dental visits because you can't afford them now.

Consumer Credit Counseling Service

- If you can't pay your bills, postpone further credit purchases, talk with your creditors, or seek help from a non-profit credit counseling service.
 - Make an appointment.
 - Businesses pay for its operation.
 - Provides education about credit.
 - Provides help with spending plan.
 - Provides debt counseling service for those with serious financial problems.

Alternative Counseling Services

- Universities, county extension agents, credit unions, and military bases.
- MasterCard's "In the Red" brochure has advice and resources for managing debt. Call 1-800-633-1185 for a free copy.

Declaring Personal Bankruptcy

- Personal bankruptcy rate is the highest it has ever been.
- Bankruptcy was designed as a last resort but has become an “acceptable” tool of credit management.
- The 1999 Bankruptcy Reform Act is designed to end abuses of the current system.

Bankruptcy: The Last Resort

- Chapter 13
 - Plan to pay a portion of your debt.
 - Trustee distributes money to your creditors.
 - Can keep most of your property.
 - Must have a regular income.
- Chapter 7
 - Submit a petition and pay a fee.
 - Lawyers charge approx \$500, including court costs.
 - Can keep some property.
 - Idea is a fresh start.

After Bankruptcy You No Longer Owe

- Retail store charges
- Bank credit card charges
- Unsecured loans
- Unpaid hospital or physician bills

After Bankruptcy You Still May Owe

- Taxes and fines
- Child support & alimony
- College loans & Co-signer obligations
- Illegal debts