

## Understanding credit and debt

How you manage credit can affect many aspects of your life. It can affect your peace of mind, if you are struggling to repay loans and credit cards. It can impact whether you reach future goals, such as buying a house. It can also be a factor in whether you are able to obtain employment, rent an apartment or buy insurance.

### How does credit work?

Credit enables you to buy an item or service now, and pay for them later, usually over a period of time. A lender, typically a financial institution or other company, loans you the money up to a certain limit, which you repay. Payments are usually made monthly. With the payment, you also pay interest expressed as the annual percentage rate (APR) on the unpaid balance. Missed monthly payments can result in fees or an increase in APR. APRs vary greatly by lender and type of loan, so it is important to compare your options.

### What are the most common types of loans and credit?

- Installment credit—also known as closed-end credit, an installment loan is used to finance a set amount for a specific period of time. The borrower is required to follow a regular payment schedule (usually monthly) that includes interest charges, until the loan is paid off. An auto loan is an example of installment credit.
- Revolving credit—also known as open-ended credit, this option allows the credit to be used as needed for multiple purchases over time. The credit user has an assigned dollar limit, which should not be exceeded. A monthly minimum payment is required. Interest is charged on any remaining balance owed. The most common form of revolving credit is credit cards, but other lines of credit also fall into this category.

### What is meant by a credit score?

Your credit score is a number used by lenders to measure your ability and intent to pay your bills on time. It is typically used to evaluate the risk involved in providing a loan or credit card to you, and is one of the factors to determine whether you are approved. You should know that your credit score can impact decisions made by insurance companies, landlords, employers, utility and cell phone companies as well. Our “Understanding Your Credit Score” is attached which provides you with more information.

### Should I avoid credit cards?

Often, credit cards are viewed negatively, because they are easy to use and often cause people to have more debt than they can easily repay. However, if used properly, credit cards can be useful and convenient. They can help build a strong credit history that will help with future activities like buying a home. Our “Using Credit Cards” guide is attached and presents pros and cons, provides basic credit card terminology and offers advice on managing a credit card.

### I am already in trouble with credit cards and debt. What should I do?

First stop using credit. Commit to live within your means and develop a plan for paying down debt. A good approach is to reduce spending and apply the savings to a single credit account until it is paid off. Once that account is paid off, use the same strategy to focus on another account. Read our “Overcoming Debt Problems” guide which is attached for more detailed information on reducing debt and improving your credit score.