

## Economics: Applying for Credit, Reading a Credit Report, and Using Credit Wisely

Imagine that a complete stranger walked up to you on the street and asked you to loan them \$20,000 so that they could buy a new car. Assuming that you actually had the money to lend, what details about the borrower would you want to know about before handing over the cheddar? What other decisions would you have to make that involve lending out that bread to someone and hoping to get it back?

### **Reading a Credit Report**

When applying for a loan, lenders rely heavily on your credit report in making a final decision. But they take other personal factors into account as well, especially things that are not allowed to be included in your credit report and credit score. They break these down into the 3 C's. *List and describe the 3 C's and give examples of questions that lenders may ask about each of these qualities.*

What credit scores are offered the best rates for loans? What credit scores are offered the worst rates for loans or are simply denied any type of credit? How do lenders justify their decisions about who gets the best and who gets the worst? (Hint: use the chart)

## Credit Report of John Q. Consumer

Answer the following questions as you read through John's credit report:

1. Page 1
  - a. What is the date of the report?
  - b. Where does this credit bureau get information about you from?
  - c. How many possibly negative items are included in his report?
  - d. How many possibly positive items are included in his report?
  - e. What is his credit score?
2. Pages 2, 3 and 4
  - a. What general information about you is included in these pages?
  - b. How can you tell when an item in your credit report will negatively effect your score?
  - c. What does it mean if your credit report includes public record information?
  - d. What is a civil claim judgement?
  - e. What is Chapter 7 bankruptcy?
  - f. What can you tell about John if there is joint responsibility for these debts?
  - g. What is a charge off?
  - h. What does it mean if something is going to continue on record until a certain date?
  - i. Do items 5,6, and 7 have a positive or negative effect on John's credit score?
  - j. What is the difference between installment and revolving types of credit?
3. Page 5
  - a. What types of information is included on page 5?

- b. What happened between August and November of 2006 to John's American Finance Account?
  
4. What information is included on page 6?
  
  
5. What information is included on page 7?

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### **Evaluating Three Loan Applications**

Follow the directions on pages 103 and 104 to evaluate the 3 loan applications.

### **You Be the Financial Advisor**

Another part of getting credit is using it wisely. Even though you may qualify for credit due to your good credit score and positive answers to your 3 C's, sometimes it is best to pay for things that you want in cash, find a less expensive substitute for the item you want, or skip the purchase altogether. Follow the instructions in the "Sharp Financial Advisors" section of the packet and advise your four clients if they should pay for their items using credit or not.

NAME: \_\_\_\_\_ CLASS PERIOD: \_\_\_\_\_

## Reading a Credit Report

Your ability to qualify for a loan depends on a credit report. A credit report is a record of an individual's personal credit history. It is probably a good indicator of the applicant's character and whether he or she will repay borrowed money as agreed.

When someone applies for a loan, the lender will order a credit report to see how well the applicant has managed credit in the past. A credit report will tell, in detail, how much the person has borrowed, from whom, and whether the bills have been paid on time.

Credit reports are compiled by credit bureaus, which regularly collect information on millions of consumers. Credit bureaus get information from a variety of sources, including stores, credit card companies, banks, mortgage companies, and medical providers. When you fill out an application for credit, the information on that application is also sent to a credit bureau.

### What Are Lenders Looking For?

Lenders look for certain qualities in loan applicants. These qualities are called the 3 Cs of Credit: capacity, character, and collateral. A discussion of each follows.

**Capacity:** Capacity refers to the loan applicant's ability to repay the debt in question. The basic question is "Have you been working regularly in an occupation that is likely to provide enough income to support your use of credit?" More particular questions might address the following:

- ✓ Do you have a steady job?
- ✓ What is your salary?
- ✓ How reliable is your income?
- ✓ Do you have other sources of income?
- ✓ How many other loan payments do you have?
- ✓ What are your current debts?
- ✓ Do you pay alimony or child support?
- ✓ Can you afford your lifestyle?

**Character:** Questions will be asked to determine whether you are honest and reliable—thus likely to pay debts. Here are some examples:

- ✓ Have you used credit before?
- ✓ Do you pay your bills on time?
- ✓ Do you have a good credit report?
- ✓ Can you provide character references?
- ✓ How long have you lived at your present address?
- ✓ How long have you been at your present job?

**Collateral:** Collateral refers to assets that could be sold to pay off your loan in the event that you could not do so. Collateral serves as a type of insurance for the creditor. Questions related to collateral may include the following:

- ✓ Do you have a checking account?
- ✓ Do you have a savings account?
- ✓ Do you own any stocks or bonds?
- ✓ Do you have any valuable collections or jewelry?
- ✓ Do you own your own home?
- ✓ Do you own a car?
- ✓ Do you own a boat?

### The Importance of a Good Credit Rating

A *good* rating on a credit report means that, in the past, bills have been paid on time. A *poor* rating indicates overdue payments or bills that have gone unpaid.

It is extremely important to build and maintain a good credit history. A good credit report can often make the difference between getting a loan or being turned down. In addition, potential employers and landlords will often check an applicant's credit report before making a final decision about offering a job or a renting out an apartment.

### Credit Reports May Contain Errors

Mistakes can and do sometimes occur on credit reports. For example, a credit report may contain information about a different person with the same name as the applicant, or paid accounts may be listed incorrectly as unpaid. The law provides individuals with a means of requesting and reviewing their credit reports and having mistakes corrected. Under the Fair and Accurate Credit Transactions Act you have the right to get a free copy of your credit report from each credit bureau annually. The official site established by the three credit reporting agencies for free reports is

[www.annualcreditreport.com](http://www.annualcreditreport.com). The Fair Credit Reporting Act allows you to receive a free copy of your credit report if you are turned down for credit or are the victim of identity theft. The three largest credit bureaus are:

- ✓ Equifax
- ✓ Experian
- ✓ TransUnion

### What's My Score?

Credit reporting agencies summarize much of the information in your credit report into one credit score. The formula for computing credit scores was developed by Fair Isaac Corporation; the scores are commonly referred to as FICO scores. The scores range from 300 to 850, with the median score being 723. People with lower scores are more likely to be denied credit or charged higher interest rates. People with scores of 770 or higher will receive the best rates for loans. Scores of 640 or more will qualify applicants for fairly good rates. People with scores of 600 or less will have difficulty getting a loan. These people probably need credit counseling.

The following chart shows how lenders use FICO scores to evaluate loan applicants. For example, the chart shows that 8 percent of borrowers had FICO scores of 550 to 599, and approximately half of them either didn't pay back money they owed or were more than 90 days late in making their payments. In contrast, 27 percent of borrowers have a score of 750 to 799, and only 2 percent of them were delinquent.

### FICO Scores: Measure Credit Risk

How Borrowers Rank		Delinquency Rates by FICO Scores	
Up to 499	2%	Up to 499	87%
500 to 549	5%	500 to 549	71%
550 to 599	8%	550 to 599	51%
600 to 649	12%	600 to 649	31%
650 to 699	15%	650 to 699	15%
700 to 749	18%	700 to 749	5%
750 to 799	27%	750 to 799	2%
800 +	13%	800 +	1%

Source: Fair Isaac

# Credit Report of John Q. Consumer

<h2>Credit R Us</h2>	<b>Prepared for</b> John Q. Consumer	<b>Report date</b> June 01, 2009						
	<b>Report number</b> 1687771839-0000051088	Page 1 of 7						
<b>Personal Credit Report</b>	<b>Report number</b> Below is a summary of the information contained in this report.	<b>Credit R Us</b> P.O. Box 9595 Allen TX 75013-9595						
<b>About this report</b> Credit R Us collects and organizes information about you and your credit history from public records, your creditors, and other reliable sources. We make your credit history available to your current and prospective creditors and employers as allowed by law. We do not grant credit or evaluate your credit history. Personal data about you may be made available to companies whose products and services interest you.	<b>Potentially negative items listed</b>	<b>If you have questions</b> For all questions about this report, please call us at: <b>1-888-000-0000</b> M - F 7:30am – 7:00 pm CT						
<i>Important decisions about your creditworthiness are based on the information in this report. You should review it carefully for accuracy.</i>	<table> <tr> <td>Public records</td> <td>2</td> </tr> <tr> <td>Accounts with creditors and others</td> <td>2</td> </tr> <tr> <td><b>Accounts in good standing</b></td> <td><b>3</b></td> </tr> </table>	Public records	2	Accounts with creditors and others	2	<b>Accounts in good standing</b>	<b>3</b>	To learn more about Credit R Us or for other helpful information, including tips on how to improve your creditworthiness, visit our web site: <a href="http://www.creditrus.com">http://www.creditrus.com</a>
Public records	2							
Accounts with creditors and others	2							
<b>Accounts in good standing</b>	<b>3</b>							
	<b>Credit Score</b> 550							

## Credit R Us

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## Information affecting your creditworthiness

Items listed with dashes before and after the number, for example -1-, may potentially have a negative effect on your future credit extension and are listed first on the report.

Credit grantors may carefully review the items listed below when they check your credit history. Please note that the account information connected with some public records, such as bankruptcy, also may appear with your credit accounts listed later in this report.

*Important decisions about your creditworthiness are based on the information in this report. You should review it carefully for accuracy.*

## Your statement

At your request, we've included the following statement every time your credit report is requested.

*"My identification has been used without my consent on applications for credit. Please call me at 999.999.9999 before approving credit in my name."*

## Public record information about you

Source/ Identification number	Location number	Date filed/ Date resolved	Responsibility	Claim amount Liability amount	Comments
-1- HOLLY COW DIST CT 305 MAIN STREET HOLLY NJ 08060	B312P7659	3-2005/NA	Joint	\$3,765/NA	Status: civil claim judgement filed. Plaintiff. Dime Savings. This item is scheduled to continue on record until 3-2012. This item was verified on 8-2005 and remained unchanged.
-2- BROWN TOWN HALL 10 COURT STREET BROWN NJ 02809	Bk443PG14	11-2005/NA	Joint	\$57,786/NA	Status: chapter 7 bankruptcy discharged. This item is scheduled to continue on record until 11-2015. This item was verified on 8-2005 and remained unchanged.

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## Credit information about you

Source/Account number (except last few digits)	Date opened/ Reported since	Date of status/ Last reported	Type/Terms/ Monthly payments	Responsibility	Credit limit or original amount/ High balance	Recent balance/ Recent payment	Comments
-3- FIDELITY BK NA 300 FIDELITY PLAZA NORTHSHORE NJ 08902 4657500024	6-2002/ 6-2002	12-2004/ 12-2004	Installment/ 10 months/\$0	Individual	\$4,549/NA	\$4,549 as of 12-2004	Status: Charge off. \$4,549 written off in 12-2004. This account is scheduled to continue until 12-2011.
-4- B.B. Credit 35 WASHINGTON ST. DEDHAM MA 547631236	10-1998/ 4-2003	4-2006/ 4-2006	Installment/ 80 months/\$34	Individual	\$8,500/\$8,500	\$0 as of 4-2006/ \$34	Status: Debt reincluded in chapter 7 bankruptcy. \$389 written off in 3-2006.  Account history: Collection as of 9-2003 thru 6-2004 90 days as of 7-2003 60 days as of 11-2002, 6-2003. 30 days as of 9-2002, 1-2003 and 2 other times. This account is scheduled to continue on record until 2-2009. This item was verified and updated on 6-2004.



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<b>Credit information about you</b> <i>continued</i>							
Source/Account number (except last few digits)	Date opened/ Reported since	Date of status/ Last reported	Type/Terms/ Monthly payments	Responsibility	Credit limit or original amount/ High balance	Recent balance/ Recent payment	Comments
5 FIRST CREDIT UNION 748 WASHINGTON LNE LANEVILLE TX 76362 129474 Mortgage: 74848347834	3-2004/ 3-2004	11-2006/ 11-2006	Installment/ 48 Months/\$420		\$17,856/NA	\$0 as of 11-2006/ \$420	Status: open/never late.
6 AMERICAN FINANCE CORP PO BOX 8633 COLLEY IL 60126 6376001172...	6-2001/ 7-2001	11-2006/ 11-2006	Revolving/NA \$400		\$18,251	\$0 as of 11-2006	Status: card reported lost or stolen. This account is scheduled to continue on record until 11-2009.
7 NATIONAL CREDIT CARD 100 THE PLAZA LAKEVILLE NJ 08905 420000638...	6-2001/ 6-2001	11-2006/ 11-2006	Revolving/NA/ \$0	Joint with JANE CONSUMER	\$8,000 \$8,569	\$0 as of 11-2006	Status: open/never late.

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<b>Your use of credit</b>							
The information listed below provides additional detail about your accounts, showing up to 24 months of balance history, your credit limit, high balance or original loan amount. Not all balance history is reported to Credit R Us, so some of your accounts may not appear. Also, some credit grantors may update the information more than once in the same month.							
Source/Account number	Date/Balance						
6 AMERICAN FINANCE CORP. 6376001172	11-2006/\$0	10-2006/\$4,329	8-2006/\$0	5-2006/\$0	2-2006/\$250	1-2006/\$0	12-2005/\$2,951
	9-2005/\$3,451	7-2005/\$4,251	5-2005/\$4,651	2-2005/\$5,451	1-2005/\$5,851	12-2004/\$6,251	
	11-2004/\$6,651	9-2004/\$7,051	7-2004/\$7,451	5-2004/\$7,852	3-2004/\$8,251	1-2004/\$12,651	
	12-2003/\$9,051	11-2003/\$9,451	9-2003/\$10,251	7-2003/\$10,651	5-2003/\$11,051		
<i>Between 1-2002 and 11-2006 your credit limit was unknown.</i>							
7 NATIONAL CREDIT CARD 420000638	11-2006/\$0	9-2006/\$542	7-2006/\$300	6-2006/\$686	4-2006/\$1,400	3-2006/\$2,500	1-2006/\$2,774
	12-2005/\$599	9-2005/\$873	7-2005/\$1,413	5-2005/\$1,765	4-2005/\$2,387	3-2005/\$3,400	
	2-2005/\$3,212	1-2005/\$4,412	12-2004/\$2,453	9-2004/\$2,453	10-2004/\$1,769	8-2004/\$1,200	
	4-2004/\$3,200	2-2004/\$4,568	1-2004/\$5,582	12-2003/\$3,000	10-2003/\$3,200	8-2003/\$4,500	
<i>Between 6-2001 and 11-2006 your credit limit was \$8,000.</i>							

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**Others who have requested your credit history**

Listed below are all those who have received information from us in the recent past about your credit history.

**Requests initiated by you**

You took actions, such as completing a credit application that allowed the following sources to review your information. Please note that the following information is part of your credit history and is included in our reports to others.

Source	Date	Comments
ABC MORTGAGE 64 MAPLE ROSEVILLE, MD 02849	10-18-2006	Real estate loan of \$214,000 on behalf of State Bank with 30 year repayment terms. This inquiry is scheduled to continue on record until 10-2009.

**Other requests**

You may not have initiated the following requests for your credit history, so you may not recognize each source. We offer credit information about you to those with a permissible purpose, for example, to:

- other creditors who want to offer you pre-approved credit;
- an employer who wishes to extend an offer of employment;
- a potential investor in assessing the risk of a current obligation;
- Credit R Us Customers Assistance to process a report for you;
- your current creditors to monitor your accounts (date listed may affect only the most recent request).

We report these requests **only** to you as a record of activities, and we do not include **any** of these requests on credit reports to others.

Source	Date
CREDIT R US PO BOX 949 ALLEN TX 75013	3-09
WORLD BANK PO BOX 949 ALLEN TX 75013	3-09, 12-08, 9-08, 6-08, 3-08, 12-07, 9-07, 6-07, 3-07
FIDELITY BK NA 300 FIDELITY PLAZA NORTHSHORE NJ 08902	1-09, 7-08, 1-08, 7-07, 1-07
NATIONAL CREDIT REPORT 100 THE PLAZA LANEVILLE NJ 08905	7-07, 2-07

## Credit R Us

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**Personal information about you**

The following information associated with your records has been reported to us by you, your creditors, and other sources. As part of our fraud prevention program, a notice with additional information may appear in your report.

**Names**

John Q. Consumer

**Residences**

Our records show you currently are a homeowner. The geographical code shown with each address identifies the state, country, census tract, block group, and Metropolitan Statistical Area associated with each address.

Address	Type of address	Geographical code
7972 PADDOCK CT LANEVILLE, TX 00000	Single Family	0-192053-3-0
1777 BEVERLY AVE SOMEWHERE, NJ 00000	Single Family	0-224681-25-0
250 GARDEN DRIVE ANYWHERE, NJ 00000	Single Family	0-9004-93-0

**Social Security number**

111-11-1111

**Year of birth**

1964

**Driver's license number**

CA X123456

**Spouse's name**

JANE

**Driver's license number**

CA X123456

**Notices**

The first Social Security number listed shows that credit was established before the number was issued.

NAME: \_\_\_\_\_ CLASS PERIOD: \_\_\_\_\_

## Evaluating Three Loan Applications

Listed below are three loan applicants who are interested in buying a new car. Based solely on the information provided and their credit score, determine whether you would approve or decline their loan requests. There is no specific credit score for which lenders would deny a loan automatically, based only on a score. However, the credit score does provide useful information about the creditworthiness of the individual. If you decide to make a loan to the applicant, assign an interest rate appropriate for the applicant's score. Check your response and then write the reason for your decisions. Interest rates typically assigned to various credit scores are provided on the following page.

Status codes given at the end of the reports.

JANICE BROWN			Credit Score 450			
Company name	Months reviewed	High credit	Terms	Balance	Past due	Status
Sears	2	2,016	24	838		R3
Dept. of Educ.	7	1,507		1,507	158	I5
Dept. of Educ.	2	512		512	512	I5
ABC Credit Card	8	3,000	29	1,363		R1
Record of Month	6			28	38	O3

\_\_\_\_\_ Approve    \_\_\_\_\_ Decline    \_\_\_\_\_ Not Sure    \_\_\_\_\_ Interest Rate

Why?

TITO SANDERS			Credit Score 770			
Company name	Months reviewed	High credit	Terms	Balance	Past due	Status
Hometown Bank	24	11,000	60	5,350		I1
ABC Credit Card	6	2,500	36	0		O0
Dept. of Educ.	5	2,000	24	1,380		I1
XYZ Credit Card	12	3,000	24	495		R1

\_\_\_\_\_ Approve    \_\_\_\_\_ Decline    \_\_\_\_\_ Not Sure    \_\_\_\_\_ Interest Rate

Why?

MARIA MARTINEZ		Credit Score 620				
Company name	Months reviewed	High credit	Terms	Balance	Past due	Status
Hometown Bank	13	7,200	48	5,800		I1
ABC Credit Card	7	2,000	24	488		R1

\_\_\_\_\_ Approve    \_\_\_\_\_ Decline    \_\_\_\_\_ Not Sure    \_\_\_\_\_ Interest Rate

Why?

### Status Codes

#### Type of account

- O = Open
- R = Revolving
- I = Installment

#### Timeliness of payment

- 0 = Approved, not used
- 1 = Paid as agreed
- 2 = 30 days past due
- 3 = 60 days past due
- 4 = 90 days past due
- 5 = 120 days past due
- 7 = Making regular payments under wage earner plan
- 8 = Repossession
- 9 = Seriously delinquent/bad debt (paid or unpaid; charged off account)

FICO SCORE	APR
720-850	6.098%
690-719	7.644%
660-689	9.059%
620-659	11.761%
590-619	15.478%
500-589	16.202%

NAME: \_\_\_\_\_ CLASS PERIOD: \_\_\_\_\_

## Sharp Financial Advisors

### Part 1: Your Job

You run a small consulting business, giving advice to people who are thinking about applying for credit. For a small fee, you offer your customers advice on whether they should apply for a loan. Your business has been successful because you understand the advantages and disadvantages of using various forms of credit. You ask your clients what is most important to their future success, and you compare the advantages of using credit to the disadvantages of using credit, according to the following general principles.

#### Advantages of using credit:

- Credit can help people acquire valuable assets.
- Credit can help people lead happier lives.
- Credit can help people in an emergency.

#### Disadvantages of using credit:

- People may use too much credit in relation to their income.
- Credit requires borrowers to pay interest to lenders; interest payments leave borrowers with less money to spend on things they may want to have now and until the loan is paid off.
- Misusing credit can put borrowers at a disadvantage, threatening their ability to qualify for loans in the future or requiring them to pay higher rates of interest on loans they may obtain in the future.

Bearing these general principles in mind, read the four cases described on the next two pages. After reading each client's case, answer the questions that follow.



**Part 2: The Four Cases****Client 1**

I am 17 years old and a high school senior. I have earned good grades in high school. I have been admitted to a good state university. I would like to go to college full-time and work only a few hours a week. With this schedule, I think that I can complete my college degree in four years. I am planning to major in chemical engineering. My college advisor has told me that chemical engineering is a hard major. My parents have no money to support me in college. I am planning to apply for aid and to use college loans to pay for my college tuition and books. I plan to live at home and work in the summer to earn spending money for use during the school year. I will be borrowing about \$50,000 in total. Should I apply for the loan?

- a. What is the main advantage of getting credit in this case?
- b. What is the main disadvantage of getting credit?
- c. Is the loan being used to purchase a valuable asset?
- d. Do you think the client is likely to be able to repay the loan?
- e. Do you recommend that this client apply for the loan? Explain.

**Client 2**

I am 18 years old. I attend the local vocational-technical school. My area of study is commercial heating and cooling. My school tuition is relatively low and I will complete my program of study in nine months. I can pay most of my expenses by working full-time in the summer and part-time during the school year. I am still living at home, and I plan to get an apartment of my own next year. I am an avid sports fan. I have a little 12-inch television set in my room. I'd like to use my credit card to buy a flat screen 38-inch television set at a cost of \$1,300.

- a. What is the main advantage of getting credit in this case?
- b. What is the main disadvantage of getting credit?
- c. Is the loan being used to purchase a valuable asset?
- d. Do you think the client is likely to be able to repay the loan?
- e. Do you recommend that this client apply for the loan? Explain.

**Client 3**

I am 21 years old and finishing my last year in college. I have been studying hard and have earned relatively good grades. My major is English. A small group of my friends want to bust out for spring break and take a one-week vacation in Florida. I have never really had a vacation while in college except for two trips with my family. If I book my reservations now, I can get relatively low air fare and hotel rates. In all, the trip will cost me about \$1,500. I am a little low on cash. I am planning to charge the \$1,500 on my credit card.

- a. What is the main advantage of getting credit in this case?
- b. What is the main disadvantage of getting credit?
- c. Is the loan being used to purchase a valuable asset?
- d. Do you think the client is likely to be able to repay the loan?
- e. Do you recommend that this client apply for the loan? Explain.

**Client 4**

I am 22 years old. I am just about to complete a two-year dental hygienist program at a local vocational school. My first-year pay will be about \$25,000 plus fringe benefits including health insurance and a 401k program. My workplace is 20 miles from my apartment and is not on a city bus route. The car I have has 225,000 miles on the odometer, and it burns more oil than gas. Yesterday, I noticed that I can see the road through a hole in the floor in front of the driver's seat! I have saved \$2,000 for a down payment on a new car, but I will need to borrow several thousand more to buy a new car that is fuel-efficient and dependable.

- a. What is the main advantage of getting credit in this case?
- b. What is the main disadvantage of getting credit?
- c. Is the loan being used to purchase a valuable asset?
- d. Do you think the client is likely to be able to repay the loan?
- e. Do you recommend that this client apply for the loan? Explain.