MODULE

# Financial Fitness

Before you can become an experienced investor, there's some important information you need to know about managing your financial fitness: and much like a workout routine, it involves sticking to a few key habits in order to have access to capital through credit.

Dive into the world of credit scores, why they matter for everything from credit cards to homes, and learn about how you can prepare for retirement using mutual funds, establishing consistent savings patterns, and possibly investing in insurance.

POWERED BY

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# Key Takeaways From This Module

## Guiding Questions

- What is personal debt and how can it be a good thing?
- What is a credit score and why is maintaining a good score important?
- How can I maintain a good credit score?
- What are some of the basics of credit cards and how can I manage them?

## Enduring Understandings

- How can you maintain a good credit score in order to retain access to lower borrowing costs?
- What are the risks associated with credit cards and how can we avoid them?
- How can I calculate my monthly mortgage payment and evaluate if I can afford debt?

# Key Terms About Credit and Debt

**Credit Card:** A payments solution that allows consumers to borrow money for everyday purchases, and pay the accrued debt back as a credit card bill.

**Loan:** Home loans, car loans, and all other types of loans are issued by banks and allow spenders to make big purchases with borrowed money. The loan must be paid back over a set timeline, and accumulates interest over time.

**Foreclosure:** If a borrower cannot pay back a loan with liquid assets(money), the bank is privy to other assets; foreclosure occurs when the bank acquires the borrower's home.

**Predatory lending:** Any type of loan that has unfair terms such as high fees or interest rates, or is simply fraudulent.

# What Are Debt & Credit?

Debt is an obligation that requires one party, the debtor, to pay money or other agreed-upon value to another party, the creditor. Debt is a deferred payment, or series of payments, which differentiates it from an immediate purchase. The debt may be owed by a country, local government, company or an individual.

Credit is often used interchangeably with debt, however, in the context of personal debt, credit often refers to the creditworthiness or credit history of an individual.

**In essence: Credit reflects how likely are you to pay back your debt.**

# The World of Personal Debt

**Personal debt is a huge part of the American economy, with the average American holding $90,460 in debt!**

These are debts taken on by individuals or households for the purpose of consumption. You have probably heard of multiple forms of personal debt such as mortgages, car loans, credit card debt, student loans, etc.

**Consumer leverage ratio(CLR)** is an important ratio that measures the amount of debt you hold in relation to disposable income.  **10% - 20%** is the advised range.

$$CLR = \frac{\textit{Total Debt}}{\textit{Disposable Personal Income}}$$

## Types of Personal Debt

### Revolving Debt

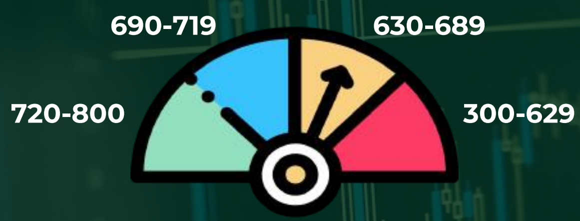
Credit cards are a form of this debt. You have limits on how much you can borrow and minimum repayments to make, but beyond that you can borrow and repay at your own discretion. Interest rates are high and variable, and borrowing is a more continuous process

### Non-revolving Debt

Here, you have a fixed principal and fixed interest rate that is paid down with fixed scheduled payments. You receive the entire borrowed amount upfront

# The Basics Of Credit Scores

A credit score is a number lenders use to estimate how likely you are to repay borrowed money and pay bills. It ranges from 300 to 800 and is calculated by credit scoring companies.




## High Credit Score

A good credit score gives you access to more credit, lower interest rates, and lower deposits. Landlords are also more likely to rent to you with a higher credit score.

## Low Credit Score

You might still have access to credit with a lower credit score but it comes with high interest rates and deposits. Landlords might not rent to you or will require higher security deposits

## What goes into your credit score?

**Most important:**

Paying bills on time

Credit utilization

**Less important but still relevant:**

Credit age
(average age of your accounts)

Credit mix
(having multiple types of credit)

Number of hard inquiries
(checks on your score when you apply for new credit)

# Why Is Credit Important?

Having good credit is important because it lets companies know how you have managed your debt previously to better predict your future ability to pay off debts. A good credit score also allows you to borrow money at lower interest rates, get better deals on credit cards, and much more that many take for granted.

***That's because with a low credit score, things become a lot harder.***

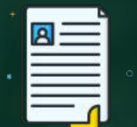
If you're able to get a loan, you'll face a much higher interest rate because lenders will not trust your creditworthiness. A low credit score may prohibit you from renting a car or an apartment, or obtaining basic utilities once you have moved in. It also may preclude you from most credit card programs and in the worst cases: show up on a background check for future employers.

**These are the 4 main categories where credit is important:**

**Access to Credit Cards**

**Mortgages & Car Loans**

**Insurance & Utilities**



**Prospective Employers**

# Tips To Keep A Good Credit Score

### Avoid Excess Credit Checks
Multiple credit inquiries by potential lenders will cause your credit score to decline as it suggests excess borrowing

### Consolidate Debts
Obtaining a debt consolidation loan at a lower interest rate will help pay off debts faster than maintaining multiple creditors

### Lock Up Cards
Maintaining credit accounts for long periods is favorably viewed. If you have delinquent accounts, resolve and maintain them

### Monitor Credit Problems
Download credit reports from Equifax, Experian, or TransUnion to help you keep track of what is helping/ hurting your score

### Lower Utilization Balances
Ideally you should pay off your credit cards each month but, if you can't, stay within 30% of your credit limit

### Pay Bills On Time
Payment history has the biggest impact on your credit score. Setting up autopay is a good way to prevent late fees and dings to your credit

# The Dangers Of A Bad Credit Score

It is easy to accumulate debt, but difficult to improve your credit score. Below are some of the main issues with having a bad credit score:

**Harder To Get a Loan**
Having bad credit means you are known to not be good at managing debt. This means banks will rarely loan anyone with bad credit.

**Fewer Renting Choices**
Many landlords do not want a tenant with bad credit because they may not pay rent, which becomes a pain for the landlord.

**Higher Insurance Costs**
As your credit score falls your insurance costs spike. The reason is that people who have bad credit tend to claim more auto insurance claims.

**Extra Expenses**
Many utility companies check your credit when creating a utilities account. However, if you have bad credit you may need to pay a deposit.

**Required for Jobs**
Some jobs require a credit check to ensure if you are handling money or are in a management position that you can handle the responsibility.

# The Power (and Risk) of Credit Cards

Having a credit card is incredibly important to raising your credit score, and a lot of credit cards come with exciting reward programs that help you travel or earn cash back.

But like everything else in finance, there's always a catch. Credit cards can be a great financial tool but they pose some serious risks that you need to understand.

# The Basics of Credit Cards

**Individual**

An individual looking to get a credit card approaches a bank. This card will be used for everyday transactions.

**Underwriting**

The bank will look at the individual, using their credit score, history of debt repayment and debt to income-level. The bank will then determine if they issue the card and what credit limit you have.

**Issue Card**

The customer is issued a credit card by the bank or a credit card company. This card can be used for purchases and the transactions are processed by the credit card company. The agreement obligates the individual to repay the credit.

**Payment Received**

A payment is received by the vendor. This will be paid by the bank or credit agency. The customer who used the card will then owe the bank the amount of the transaction.

# What's The Catch?

Credit cards work by offering a **set credit limit.** This limit is **what the provider has authorized you to spend**, and is based on what they **believe you can/will pay back**.

When a transaction is made, the credit card company records the transaction and **builds a summary** of all of your transactions for the month. **Once you receive the summary, you have a *grace period* to pay off the amount or you will incur interest.** The interest is determined and stated by the company.

**This interest rate will typically be tied to the Prime Rate, which means your interest could change over time.** This interest rate gets put into an **APR (annual percentage rate)** which includes the interest and other additional fees the bank charges you.

# How Credit Cards Can Benefit You

**Cashless Transactions**
Allows you to make purchases without needing to have cash, which is less accepted since the pandemic, and also eliminates the need to carry precise change.

**Increase Credit Score**
By consistently paying down your credit card bill on time with autopay & never over-utilizing your credit limit, you can consistently build credit for bigger loans in the future that really matter.

**Purchase Protection**
Credit card companies provide purchase protection which protects you in the event of fraud and allows you to dispute a purchase with a vendor if a product is not satisfactory, resulting in a refund.

**Rewards Programs**
Most credit card companies offer shiny rewards programs which include cash back, concert & ticket perks, and travel miles which allow you to book flights and hotels using points that you earn while you fly.

**REMEMBER:** Do not get trapped into making the minimum payments on a credit card. The goal is to improve your credit and get rewards, not hurt it and pay late fees. Plus, once you start paying interest to the credit card companies, it’s nearly impossible to recover.

# A Credit Card Is Not An Emergency Fund

It is important to consider that your credit card is not an emergency fund. There can be serious consequences if your card is used in an emergency, and you all of a sudden are loaded up on debt. Here's how things can spiral:

A credit card allows you to buy money for short periods of time. If you cannot pay off the money you borrowed, your debt grows exponentially from interest.

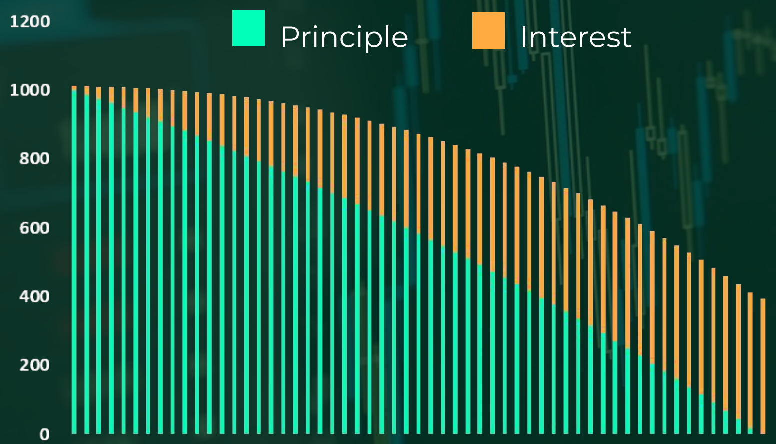
A massive unpaid bill then hurts your credit score and if your credit score drops too low your credit card company may cut you off from your credit card

This would then spread and could make it near impossible to rebuild your credit as the easiest way is through responsible use of a credit card.

# The Risk of Credit Cards: Lifelong Debt

## Meet Mitch!

Mitch has been having a hard time lately with his finances and incurred $1000 in credit card debt. His credit card company only requires a minimum payment of $25 a month but charges him a 15% interest rate on his debt. He only makes minimum payments of $25 per month, instead of paying down the $1000 in debt. Let's check out how his debt changes with time:




Poor Mitch! Even as he pays down his principle ($1000), he still has a huge amount of interest to pay due to compound interest. So instead of paying back $1000, he ends up paying almost $1400 over 4 years and 8 months!

Sometimes people use even more debt to be able to make their minimum payments which only exacerbates issues and creates a debt situation that can feel insurmountable.

# Example: A Hospital With Savings Vs. Debt

For our example we are going to look at a hospital bill that costs $20,000. **Our credit card has an interest rate of 18%,** which is normal when you first get a card. **Our minimum payment is 3% of our total owed**.

Now let's say we used our credit card to pay for the hospital bill and only paid off the minimum each month. **This chart shows us just how quickly that debt can increase** and how much of a financial burden those minimum payments can become.

| Year | Accumulated Debt | Minimum Payment |
|---|---|---|
| **0** | $20,000 | $0 |
| **5** | $41,065 | $1,453 |
| **10** | $78,456 | $2,777 |
| **25** | $547,100 | $19,367 |

# Understanding Your Rights As A Borrower

If you believe you have no hope of repaying your debt in 5 years, even if you drastically reduce spending, or if your debt exceeds half your gross income, it's time to consider some form of **debt relief.**

**Bankruptcy**

A free consultation with a bankruptcy lawyer is one of the first things you should do to determine whether you qualify for bankruptcy. If you do qualify, there are two kinds of bankruptcy:

**Chapter 7:** erases most credit card debt, unsecured personal loans and medical debt but will also lead to a damaged credit score, and property loss.

**Chapter 13:** if your income exceeds the state median or if you want to retain your property, you may pursue chapter 13 bankruptcy which is a three- or five-year court-approved repayment plan

**Debt Restructuring**

If you do not qualify for bankruptcy, there are many ways to renegotiate the terms of your debt.

**Credit counselling agencies:** they often have long standing relationships with major lenders that they leverage to help reduce your debt burden

**DIY:** you can also reach out to your creditors yourself to renegotiate the terms of your debt. Lenders like major credit card companies often have financial distress programs that facilitate this.

# Key Takeaways From This Module

## CORE & FUNDAMENTALS

- Personal debt is used for purchases that can lead to greater upward mobility such as education or home ownership.
- A good credit score will make borrowing money less costly.
- You can manage personal finances by sticking to the 50%, 20%, 30% rule.

## APPLIED KNOWLEDGE

- Especially for young people. Credit Cards can be risky tools.
- Loans are great tools for big purchases.
- It is important to plan for your future by researching retirement plans, insurance, and safe financial vehicles.

## RELEVANCE FOR YOU

- Personal debt can be a good thing, as long as it's properly managed.
- It is important to maintain a good credit score by staying on top of expenses.
- There are various types of employee-offered retirement plans to help you plan for the future.