Advantages and Disadvantages of Credit

There are both advantages and disadvantages to using credit.

Disadvantages include the following:

- **Credit costs money.** There is usually a charge for spreading payments over a period of time.
- **Credit can tempt you to spend more money than you can afford to repay.** You are more likely to purchase items that you do not need.
- **When you make a purchase using credit, you commit to using your future income to repay the loan.** It means that you will have less money in the future to spend on other things.
- **Lenders will report all missed credit payments to the credit bureaus.** This will affect your ability to get additional credit in the future.
- **If you mismanage credit and are unable to repay the lender, they may repossession, or take back, the item you purchase.**
- **Lenders, employers, and landlords often request a copy of your credit report.** If you mismanage your credit, it can affect your ability to get additional credit, get a job, rent an apartment, or buy a house in the future.

Can you think of any other disadvantages to using credit?

Advantages including the following:

- **Credit allows you to purchase large items that you might not have enough cash to pay for such as a car, house, or college education.** Sometimes household items will go on sale or be needed at a time when you do not have cash available. Credit can be used to make these purchases, so you can use the item while you take some time to pay for it.
- **Credit is a good tool in an emergency situation.** Faced with an expensive medical situation, credit enables you to spread the cost over a period of time.
- **Credit is convenient.** Using a credit card is a way to pay for things without having to carry large amounts of cash. Also, your monthly credit card statement provides you with a record of your purchases.

Can you think of any other advantages to using credit?
Using Credit

Spending money today means that it will take longer to accomplish your savings goals. Try to strike a balance between meeting your real needs and saving money. To do this, learn to recognize the difference between your needs and your wants.

Before you make a purchase, ask yourself if the item is a need or a want. Needs are items that are essential based on your lifestyle and values. Housing and education might qualify as needs. Wants are items that you desire, but that are not necessary, such as a snack or expensive clothes. Because credit generally costs money, it is best to use it for need type purchases and to satisfy your wants with cash that you save over time.

Try asking yourself the following questions before you use credit for a purchase:

- Is this purchase a need or a want?
- Do I really need the item right now, or can I wait until I have the cash?
- How much do I have to pay to borrow this money?
- How will the credit payment affect my household budget each month?
- Can I afford this?
- Will I still have the item when I am finished paying for it?
- Should I go home and sleep on my decision before using credit to make a purchase?

Using Credit Exercise

Review the following situations. Use the questions from above to decide whether credit is a good way to make the purchase. Mark your answer. List your reason in the space provided. There are no right or wrong answers.

<table>
<thead>
<tr>
<th>Item/Situation</th>
<th>Should I use credit</th>
<th>Reason</th>
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<tbody>
<tr>
<td>A friend’s birthday present</td>
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<tr>
<td>Weekly snacks</td>
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<td>College education</td>
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<td>New shoes when your shoes are still in good condition</td>
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<td>New CD, DVD, and video player because yours broke</td>
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<td>Lunch with friends</td>
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<td>A new bike</td>
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<td>Medical procedure that the doctor tells you to have done immediately</td>
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<td>Car repairs</td>
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<td>Spring break vacation to California</td>
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<tr>
<td>A car purchase when yours runs fine</td>
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Types of Credit

When used wisely, credit can be an effective tool to make purchases. There are a number of different types of credit. The most common types of credit are:

**Revolving credit** allows you to borrow money at any time up to a set limit. As you pay the borrowed money back, it becomes available again to borrow. The lender allows you to pay back the money in a lump sum or over an extended period of time. If you pay back the debt over time, you are charged a fee each month on the amount that you owe. This fee is called interest. The most common types of revolving credit are credit cards, such as VISA or MasterCard, department store cards, and gasoline cards. Make sure you understand the type of credit card you have and how interest is charged.

**Installment credit** allows you to borrow a specific amount of money at one time for a defined purpose. You establish a payment plan with your lender to repay the loan on a regular basis over a period of time. The amount of interest that you will pay is determined in advance and calculated into your set monthly payments. This type of credit is common for larger purchases such as a home, a car, or education.

**Noninstallment or service credit** allows you to pay for a used service at a later date. Some businesses and utility companies offer this type of credit. Often, if you pay the complete sum within a specified period of time, usually 30 to 60 days, you do not have to pay fees or interest. If you are unable to make the payment within the specified time, there is usually a penalty charge that will be added to your debt.

Most types of credit can be obtained in two forms:

**Secured credit** requires you to provide something of value to guarantee that you will repay your debt. It is usually used for installment loans. If you fail to repay, the lender takes your item as repayment. Personal valuables such as cash or a car are used to secure loans.

**Unsecured credit** does not require a guarantee.

Reference:

Fannie Mae: Growing Your Money – Personal Financial Tools
www.fanniemaefoundation.org/programs/finance_tools.shtml