

Assignments

Financial Plan Assignments

Your assignment is to evaluate how you are doing in managing credit. Since credit evaluation and credit scoring are important tools in the acquisition of a home and other important purchases, it is important that you understand where you stand.

Your first assignment is to get a copy of your credit report. If you are from the United States, you can, by law, obtain one free copy of your credit report each year from one of the major credit report suppliers (Experian, TransUnion, or Equifax). Go to www.annualcreditreport.com and supply the necessary information. You will select one of the major providers and input the necessary identification information, and the credit reporting agency will provide you a copy of your credit report online. You can also go to www.myfico.com; for about \$15, you can get both a copy of your credit report (from your choice of supplier) and your FICO credit score.

Once you have your credit report, read it thoroughly and ensure it is accurate. If there are problems, follow the process we discussed to improve your score and remove inaccuracies from your credit reports.

Next, review your credit score. Read through your credit score report in detail. Write down the things you can do to improve your credit score and work on them.

Learning Tools

The following Learning Tools may be helpful as you prepare your Personal Financial Plan:

18. Credit Card Repayment Spreadsheet

This Excel spreadsheet helps you determine how long it will take you to pay off a specific credit card or loan based on the balance owed, annual percentage rate, compounding periods, and payments per month.

9. Debt Amortization and Prepayment Spreadsheet

This Excel spreadsheet is a debt amortization and prepayment schedule to help you reduce and eliminate your debt.

20. Debt Elimination Schedule with Accelerator

This spreadsheet allows you to input your different debts and interest rates. It then prioritizes that debt based on interest rates and creates a repayment plan based on the minimum payments due each month. This repayment plan is consistent with Marvin J. Ashton's plan in the article "One for the Money." This spreadsheet also allows you to include an accelerator amount and an amount in addition to your

normal monthly payments; you will be able to see how long it will take you to pay off your debt.

Review Materials

Review Questions

1. What is the difference between a credit evaluation and a credit report?
2. How can you obtain one free credit report per year from each of the three credit bureaus (Equifax, TransUnion, and Experian)?
3. What should you do if you find an error on your credit report?
4. What are the benefits of having and maintaining a high credit score?
5. What are the five most important factors in determining your credit score?

Case Studies

Case Study 1

Data

Steve and Adrianna Tanner recently graduated from college and started their first jobs. Based on their combined salary of \$90,000, the bank pre-approved them for a home loan, and they found the perfect house. However, when they went in to finalize the loan, they were told they did not qualify for the loan because of their low credit scores.

Application

- A. What didn't this couple do?
- B. What should they have done?
- C. What can they do to remedy the situation?

Case Study 1 Answers

- A. Steve and Adrian Tanner did not determine their credit score before applying for a loan. Do not leave things to chance! If you know your credit score, you may be able to get a lower rate for your loan.
- B. They should have reviewed their credit reports and tried to resolve any problem areas before applying for a loan. They also should have gotten their credit score to see how they were perceived by the financial community.
- C. They can get their annual credit report free from each of the three agencies we discussed, and they can pay to get their credit score. They should then work to improve their credit score so they can get the lowest rate possible for a loan.

Case Study 2

Data

Understanding and Managing Credit

Steve carried an average daily balance of \$600 this month. His balance last month was \$1,000, and he made a \$900 payment on the 15th of this month.

Calculations

Calculate the monthly interest charges for credit card accounts that charge interest rates of 10 percent, 16 percent, 18 percent, and 24 percent.

Fill in the following chart:

	<u>10%</u>	<u>16%</u>	<u>18%</u>	<u>24%</u>
Average daily balance	\$5.00	_____	_____	_____

Application

Since the average daily balance is the most commonly used method of calculating balance, how important is it to get a low interest rate?

Case Study 2 Answers

Calculations

The formula for calculating your finance charge is your average daily balance multiplied by the interest rate divided by 12 months.

	<u>10%</u>	<u>16%</u>	<u>18%</u>	<u>24%</u>
Average daily balance	\$5.00	\$8.00	\$9.00	\$12.00

Application

If you use credit cards to finance spending (which is not recommended), it is important that you get a low interest rate on your card.

Case Study 3

Data

Bill was reading about the importance of keeping a high credit score and got his FICO score of 690. He heard a rumor that to improve his FICO score, he needed to reduce the number of cards in his name. Bill canceled three of his five credit/bank cards that he had not used in a long time. The next time he got his FICO score he discovered it had dropped by 40 points.

Analysis

- A. List three possible reasons why his score may have dropped.
- B. What should he have done to make sure the canceled cards helped, and not hurt, his score?
- C. What might he do to improve his score?

Case Study 3 Answers

A. There are three possible reasons his score may have dropped:

1. *History*: One of the cards he canceled had the longest history. His score may have dropped as his time with credit was lessened due to the dropped card.
2. *Available credit*: Each of the canceled cards had a large amount of available credit. When these were canceled, they decreased his total available credit and increased his percentage usage each month, resulting in a lower score.
3. *Mix*: Perhaps the cards canceled resulted in a mix of credit that was biased toward one type of card. This may have lowered his score.

B. He should have done the following to make sure his score did not drop:

1. *History*: He should have made sure the cards he canceled did not have the longest credit history.
2. *Limit*: Before dropping the cards, he should have gone to his existing credit/bank card companies and requested an increase in credit limit, at least to match the amount he had previously. If they would not increase the limit, he should have kept the old cards.
3. *Mix*: Even though the cards may not have been used, if they had given a better mix, it may have been wise to keep them. He should have avoided having too many of the same types of cards.

C. The following are things he might do to improve his credit score:

1. *Payment record*: Tighten his budget and save 20 percent of his income. Pay bills on time and don't miss!
2. *Amount owed*: Use that 20 percent and any additional money to pay down debt (after he has started his emergency fund). This will reduce his amount owed and his usage of available balances.
3. *Limits*: Call his credit card companies and request an increase in credit limits. This will help his use of available balances.
4. *Credit history*: Ask his parents to include him on one of their credit cards (I am not sure I would do this). This will increase his credit history (this is called piggybacking, and it works only for families, not individuals).
5. *Application history*: Do not apply for new cards. Generally, I recommend between two to four cards for most individuals. Do not get new cards just for store credit.

6. *Credit mix*: Do not apply for too many of the same type of cards.

Case Study 4

Data

Bethany, a BYU student, was reading about the importance of having a high credit score. She went to www.annualreport.com but found she has no credit history. She pays her bills on time, has a checking account, and has a debit card.

Questions

- A. Why might she not have a credit report?
- B. What can she do to improve her credit history?
- C. Does a debit card help build credit?
- D. If banks will not allow her to get a credit card, what could she do?
- E. How could she get a secured credit card?

Case Study 4 Answers

- A. She may not have credit history because she has not had much credit. Even though she pays her bills on time, the bills may be in other students' names. She may also be an international student without a social security number.
- B. She could try to get a credit card. This would be helpful to her in improving her credit history.
- C. A debit card does not help build credit.
- D. If she cannot get a credit card, she should (carefully) look into a secured credit card. If she can find one with low fees, she will put money into the card and can charge up to the amount of money on the card. Credit reporting agencies cannot tell the difference between a credit card and a secure credit card.
- E. She should check with her bank or www.bankrate.com for a card that does not charge an application or insurance fee and that has a low annual fee.