

Smart Credit & Loan Moves

CENTS | 1 Hour

Agenda

- Welcome to CENTS
- Class Goals
- Traps to Avoid
- Mindsets to Take On
- Basic Loan Terms
- Borrowing Cost Rules
- Loan Calculator Demo
- What Lenders Evaluate
- Common Traps & Smarter Options
- Good vs. Bad Debt
- Credit Basics
- Wrap-Up and Q&A



Welcome to CENTS

- Seattle-based nonprofit founded in 1995
- Co-founded by a federal bankruptcy judge and financial professionals
- Provides free, independent financial education and legal resources
- Serves seniors, students, cancer patients, justice-involved individuals — and now veterans
- Focused on practical tools, not financial products
- This program is supported by the American College of Bankruptcy Foundation.

Class Goals

1

Figure out if and how you can fit borrowing into your life

2

Distinguish “good” vs. “bad” debt

3

Learn how to prioritize loans that help you meet essential needs or worthwhile goals

4

Learn how to plan loan terms so payments fit your budget

Lending is a Major Industry

- Offering financing to consumers is a major revenue stream
- Financing can out-earn the “main business”
 - Sears made **more profit from its in-house credit cards** than from selling appliances
 - Delta and United report **billions in revenue from co-branded credit-card mileage programs**, which often exceed ticket sales.
- **Debt is widespread:** 77% of U.S. families held some form of debt in 2016 (including credit cards, mortgages, etc.).
- **Majority worry about debt:** 68% of adults with debt doubted they’d ever be debt-free

Military & Veteran Debt Statistics

- **Credit cards:** 91% of military families have ≥ 1 card (vs 69% of civilians)
- **Multiple cards:** 36% of service members have 4+ cards (vs 26% civilians)
- **High balances:** Of veterans with 4+ cards, 41% owe $\geq \$5,000$ (vs 28% civilians)
- **Repayment rates:** Only 25% of enlisted members always pay cards in full (vs 41% civilians)
- **Payday loans:** 12% of junior enlisted reported taking a payday loan last year

Traps to Avoid

The Minimum Payment Trap

- Minimum credit card payments usually cover interest and only a tiny bit of the principal, which can make the debt drag on for years
- A **\$2,000 balance** at a 21% APR with a 2%-plus-\$10 minimum payment takes over **50 years** to pay off with **\$13,084 total paid**
- **Opportunity cost:** Money paid as interest is money you *cannot* invest or save; it's lost opportunity.

The Minimum Payment Trap

Starting Balance	First Minimum Payment*	Months to Pay Off	Interest Paid (18% APR)	Total Paid
\$1,000	25	62	\$539	\$1,539
\$3,000	60	268	\$6,328	\$9,328
\$5,000	100	370	\$12,328	\$17,328

*First Minimum Payment assumes the issuer sets the payment at either 2 % of the balance or \$25 (whichever is greater) including interest at 18 % APR and no new charges.

“It will work out”

- **Trap:** Telling ourselves “it’ll work out” can lead to procrastination and inaction on debt.
- **Reality:** Without adjusting your payments or budget, debt often *grows* (through interest), not shrinks, despite hoping it won’t be a problem.
- Seeing a small minimum due gives psychological comfort, but it hides the math. You may falsely feel you’re in control.

Justifying and Rationalizing

- **Trap:** Using emotional justification like “I’ve earned this upgrade” or “Rates are low, why not?” can mask whether the payment truly fits your budget.
- **Reality:** Borrowing for wants instead of needs locks future income into debt, crowding out savings and emergency funds.
- Initial monthly payments may look manageable, but fees, variable rates, and add-ons inflate the total you’ll repay.

Mindsets to Take On

Getting Above “The Line”

Above the line:
Financial decisions
that increase your
wealth.

- Equity in your home
- Savings
- Retirement fund
- Investments

Below the line:
Financial decisions
that increase your
debt.

- Auto loan
- Mortgage
- Student loan
- Credit card debt



Plan With Today's Income

- Balance current spending with saving for future goals
- Leverage time: money invested today can grow (compound interest)
- Account for inflation: today's dollars will buy less in future
- Set clear goals (retirement, education, home) and estimate required savings
- Use savings calculators to see how contributions grow over time

Basic Loan Terms

Principal & Balance

- **Principal:** the original loan amount borrowed (does not include interest)
 - In a \$300,000 home loan, the principal is \$300,000
- **Balance:** the current amount owed on the loan
 - If you owe \$300,000, you now have a \$300,000 balance



Interest & Rate

- **Interest:** the fee (in dollars) charged for borrowing money
 - \$25k in payments needed for a \$20k loan means \$5k in interest
- **Interest Rate:** the annual percentage rate charged on the loan balance (not including fees)
 - A 5% rate for a \$20k loan means \$1k in interest over one year
- **APR:** Annual Percentage Rate includes interest plus fees (typically higher than the nominal rate)



Term & Total Repayment

- **Term:** the length of time (months/years) to repay the loan
- Longer term = lower monthly payment but higher total interest paid
- Shorter term = higher monthly payment but lower total interest
- **Total repayment:** the sum of all payments = principal + total interest
- Use shorter terms to save interest if affordable



How Loans Work

How an Installment Loan Works

- You receive a lump sum now and agree to repay **principal + interest** over time
- The lender charges **interest on the remaining balance each period**
- Each monthly payment is split:
 - **Interest first** (their profit)
 - **Whatever is left** reduces your balance
- As the balance shrinks, the interest share gets smaller and **more of each payment pays down principal**
- When the balance reaches **\$0**, the loan is fully paid
- *Warning: Pre-payment penalties*

Revolving Credit

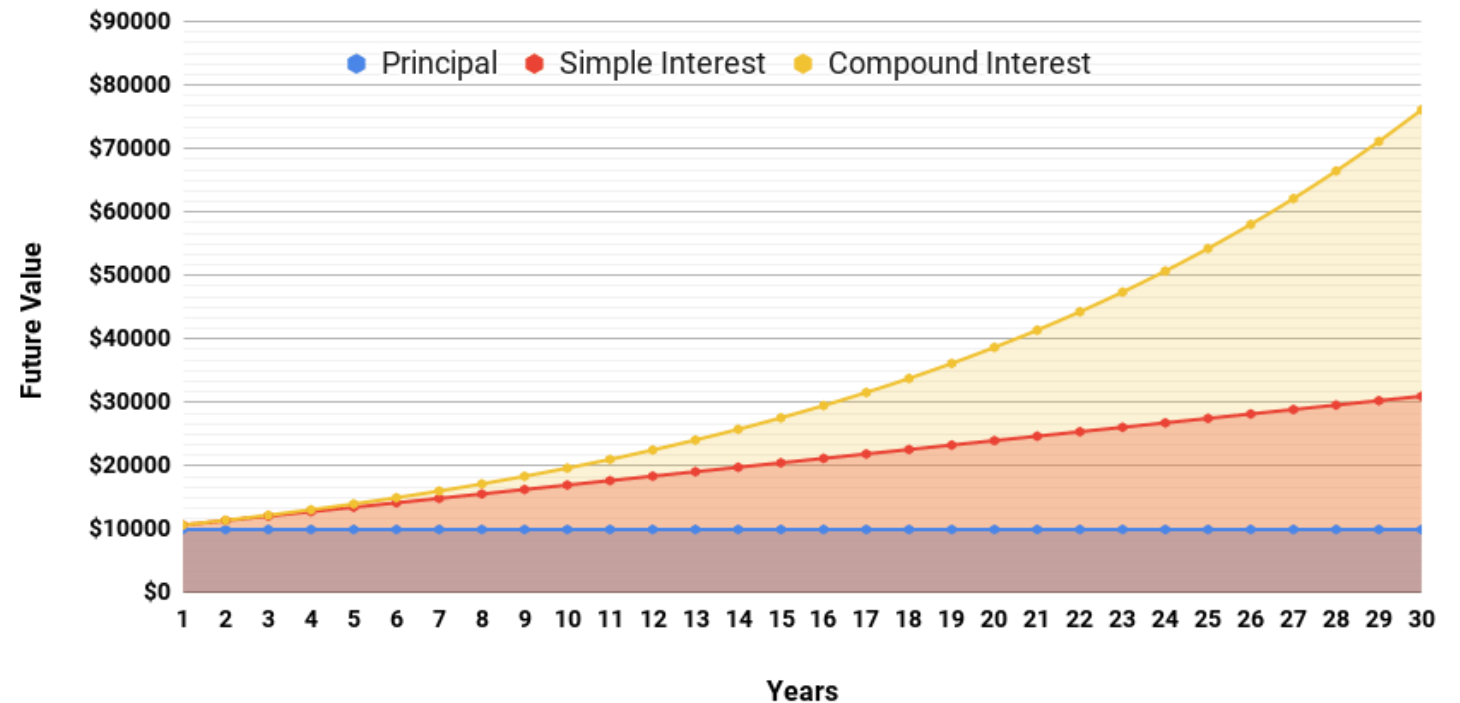
- Lender sets a **credit limit**; you can borrow, repay, and re-borrow up to that limit as needed.
- Interest accrues only on the outstanding balance; rate may be **fixed or adjustable**.
- Unlike an installment loan, the **debt remains until you choose to pay it off**.
- **Key tip:** Pay as much as feasible to avoid high, compounding interest charges.

Simple vs. Compound Interest

- **Simple interest:** interest only on original principal
 - Common on many auto and personal loans
- **Compound interest:** interest is added to the balance; future interest accrues on the new total
 - Used by credit cards and some personal loans
- Compound grows debt faster and longer terms or higher APRs magnify the effect

Compounding \$10,000 over 30 years at 7% interest

After 30 years - simple interest = \$31,000 | compounding interest = \$76,122.55



Borrowing Cost Rules

Borrowing Cost Rule 1: Time Adds Cost

- Longer loan = more interest paid
- Shorter terms save interest costs, even with higher payments
- Example (simple interest):
 - \$10,000 at 5% for 5 yrs = \$2,500 *simple* interest
 - \$10,000 at 5% for 10 yrs = \$5,000 *simple* interest
- Paying extra (or choosing a shorter term) cuts the total interest dramatically
- Remember: time is a key driver of cost (double the time roughly doubles simple interest)



Borrowing Cost Rule 2: Amount Adds Cost

- More principal borrowed = more total interest
- Example:
 - \$10,000 at 5% for 5 yrs = \$2,500 *simple* interest
 - \$20,000 at 5% for 5 yrs = \$5,000 *simple* interest
- Borrow only what you need; avoid increasing debt without necessity
- Adding fees or roll-over balances effectively increases principal (and cost)
- Treat loan increases (like cash-out refinance) with caution



Borrowing Cost Rule 3: Higher Rates Add Cost

- Higher interest rate = more interest each year
- Even a 1–2% increase in rate can add substantial cost over time
- Example:
 - \$10,000 at 5% for 5 yrs = \$2,500 *simple* interest
 - \$10,000 at 10% for 5 yrs = \$5,000 *simple* interest
- Good credit and rate shopping can save thousands
- Compare APRs to see true cost, and consider refinancing if rates drop significantly



Loan Calculator Demo

<https://www.bankrate.com/loans/loan-calculator/>

- Cover:
 - Baseline loan
 - Longer term impacts
 - Larger principal impacts
 - Higher rate impacts

What Lenders Evaluate

What Lenders Evaluate

- Verify your **identity**
- Check your **income**
- Review your **debts**
- Look at your **past borrowing behavior**
- Consider the **purpose of the loan**
- Review your **current assets**

Debt-to-Income and Future Borrowing

- **Debt-to-income (DTI) ratio:** Percentage of income used for debts (mortgage, car, credit cards).
- **Ideal DTI:** Lenders often prefer DTI under about 40–41%.
- **High DTI warning:** A high debt load limits ability to take on new loans.
- **Paying down debt:** Reducing balances frees up income and lowers DTI.
- **Future borrowing:** Keeping DTI low helps qualify for bigger loans later.
- **\$3,000 in monthly debt payments with a \$10,000 gross monthly income is 30% DTI ratio, or a low debt load**



Common Traps & Smarter Options



Common Traps: Payday Loans

- **Triple-digit cost:** fees push annual interest near 400 %, draining paychecks fast.
- **2-4 week term:** tight due dates lead many borrowers to re-borrow just to cover the first loan.
- **Snowball effect:** repeat borrowing can turn a \$300 advance into \$900+ in fees within months.
- **Washington State protections:** no loan “rollovers” and lenders must give a free 90- or 180-day installment plan if you can’t repay.



Common Traps: Predatory Car Financing

- **“No Credit, no problem” or “Buy Here Pay Here”** : Dealers may offer credit on the spot but at high cost.
- **Inflated prices:** Cars may be sold far more than their value to cover hidden fees
- **High interest & add-ons:** Loans carry very high APRs, with expensive warranties or services rolled in
- **Low underwriting:** Dealers ignore real budgets, financing loans they know borrowers can't afford
- **Defaults & repossessions:** These loans often fail and many buyers end up in repeated defaults or repossessions



Common Traps: Deferred-Interest Offers

- **Hidden interest bomb:** “0% if paid in 12 months” can be misleading. If any balance remains when the promo ends, interest is charged retroactively on the entire purchase
- **Very high APR:** These cards often carry high standard rates (e.g. 24–30%)
- **Lump-sum interest:** Failing to pay off a purchase could trigger a backdated interest charge all at once
- **Balloon interest:** One big charge can balloon your balance and even incur interest on that interest



Balloon Interest

- **Deferred-interest “0 % for 12 mo”:** Buy a sofa on a store card for **\$1,200; APR 25 % after promo.**
 - You pay down **\$1,100** during the year, leaving **\$100** balance at month 12.
 - Because it isn’t fully paid off, the lender adds **all accrued interest retroactively:**
 $25\% \times \$1,200 \times 1 \text{ yr} = \300 balloon interest.
 - Your month-12 bill is now **\$100 balance + \$300 interest = \$400** due immediately—wiping out the “savings” of the teaser rate.

Smarter Options: Compare Loan Terms

- **Compare APRs:** Look at the annual percentage rate (interest + fees) to gauge true cost
- **Check fees:** Account for origination, prepayment, late fees as these add to loan cost.
- **Loan term:** A longer term lowers payments but increases total interest; a shorter term saves interest
- **Monthly payment:** Confirm you can afford the payment; avoid loans that strain your budget.
- **Total cost of the loan:** Compare to the total cost of each loan within the lens of “The Line” and watch out for traps previously mentioned

Review the loan checklist in the handout for a more in-depth comparison



Smarter Options: VA Home Loan

- **No down payment:** VA loans often allow 100% financing (no cash down) for qualified buyers
- **No PMI:** You never pay private mortgage insurance, even with low or zero equity
- **Low interest:** VA loans generally offer competitively low mortgage rates
- **Limited fees:** Closing costs are capped by VA rules and often lower than conventional loans
- Learn more at <https://www.benefits.va.gov/homeloans/>



Trap or Tool?

- Borrowing \$200 under two-week loan (0% APR if paid; 400% if not)
 - **Trap:** Ended up with \$1,500–\$2,500 in fees (read [Joe's story](#))
- Borrowing \$500 loan at 6% APR
 - **Tool:** Not ideal, but it costs \$530 after 1 year vs. potentially thousands in payday loan
- Buying \$2,500 furniture set on 12-mo 0% deferred interest plan
 - **Trap:** \$400 charged after one year when it wasn't paid off
- \$300k home purchased with VA Home Loan at average rate (6.75% - July 2025)
 - **Tool:** No money down (though, encouraged) and no mortgage insurance, saving thousands every year

Not All Debt Is Bad

Some loans (education, mortgages, business start-ups) build value or earnings potential

“Good debt” increases net worth over time (e.g., a home’s equity, a degree leading to higher pay)

Use credit strategically (e.g., low-interest financing for a needed car or appliance), preserving cash for emergencies

Too Much “Good” Debt Still Hurts



High loan balances (even mortgages or student loans) can strain cash flow, especially if payments exceed ~36% of income



Watch your debt-to-income (DTI) ratio: above ~36–43% is a red flag that you may struggle to pay bills.



Excess debt reduces financial flexibility.



Interest Thresholds: $<7\%$ vs $>7\%$

- Stock market returns are generally around 7% per year
- Lower rates ($<7\%$) are relatively affordable; once interest climbs above 7%, borrowing exceeds the expected return on investment.
- For context, current average rates (Bankrate.com):
 - personal loans $\approx 12.6\%$ APR
 - credit cards $\approx 20\%$ APR
- Always compare APRs and terms. A 20% credit-card balance costs far more over time than a 7% car loan for the same principal.

Credit Basics

Why Credit Matters



Score Impact: A higher credit score makes loans easier to get and lowers interest rates.



Score Range: Typical scores run 300–850; 700+ is good, but <600 often face high rates or denials.



Key Factors: Scores hinge on payment history, amounts owed (utilization), credit mix, history length, and inquiries.



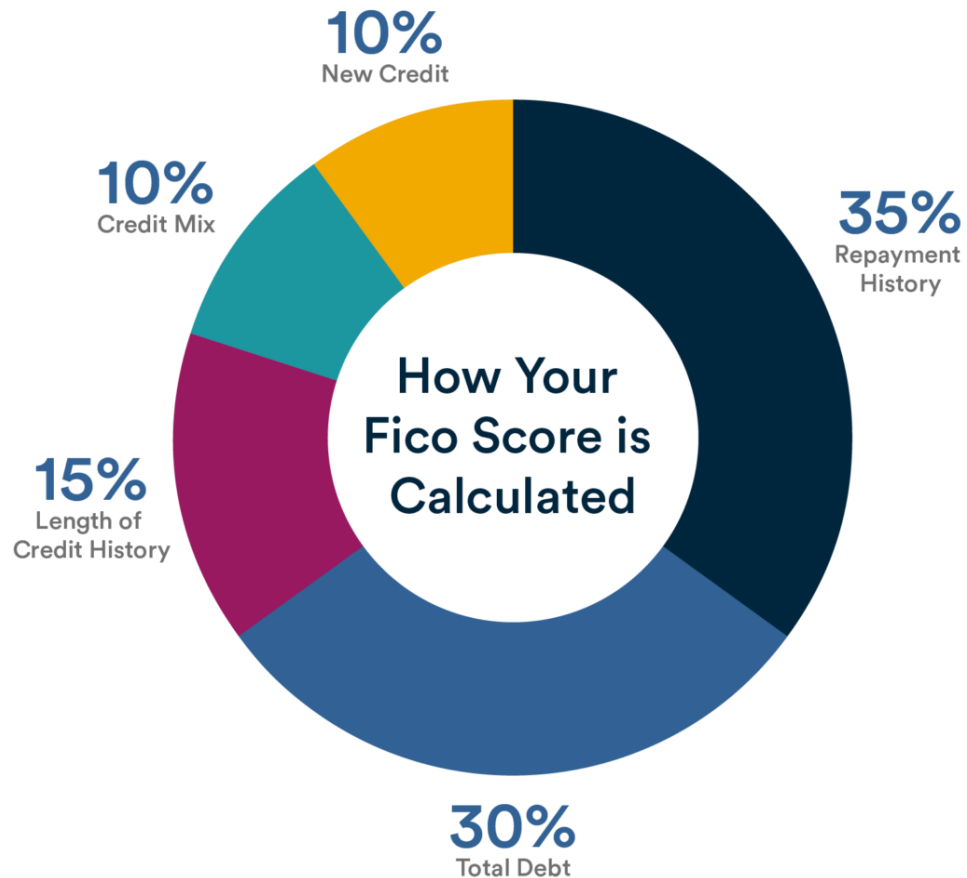
Improve Score: Always pay on time (biggest factor) and keep balances low (experts say below 30% of limit).

Credit Reports

- **Understand Reports:** Creditors report data (payment history, balances) that feed your scores. Errors or omissions can unfairly lower scores.
- **Free Reports:** You are entitled to one free report per year via AnnualCreditReport.com.
- **Check for Errors:** Review reports closely: correct mistakes (wrong name/address, fraudulent accounts) to protect your score



Credit Score



- **Score Basics:** Three-digit number (300-850) that predicts repayment risk (higher is better).
- **Five Key Factors:** Payment history, amounts owed vs limits, length of history, new credit, and mix of accounts.
- **Why It Matters:** Influences loan approval, interest rates, insurance premiums, and sometimes job offers.
- **Monitor & Build:** Check scores through your bank or free monitoring sites, pay on time, keep balances under 30 percent of limits, avoid rapid credit applications.

How Your Credit Score Impacts You

Interest rates based on credit scores

FICO Score	APR	Monthly Payment	Total Interest
760-850	5.005%	\$2,820	\$490,170
700-759	5.227%	\$2,892	\$515,974
680-699	5.404%	\$2,949	\$536,765
660-679	5.618%	\$3,020	\$562,155
640-659	6.048%	\$3,164	\$613,990
620-639	6.594%	\$3,351	\$681,316

Source: myFICO (August 2022)

**Based on average home price and APR in Aug 2022:
approx. \$520,000 @ 6% APR*

Class Materials

Loan Checklist

Credit Report
Dispute Guide
(with sample
Dispute Letter)

Credit & Loan
Calculators

Please fill out the Survey!

Thank you for your participation

Please complete the survey at the link in the chat. It really helps us improve the class!

Q&A

- Open discussion and questions
- Preview upcoming classes
- Resources
 - Supplemental materials
- Thank you for participating!