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Oregon State University and the United States Department of Agriculture cooperating.
Use Your Consumer Credit Wisely

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Consumers as they make their purchases of goods and services find that "buy now, pay later" has become a way of life in the United States. This seems to be an age of "easy credit." Consumers are constantly being urged to use credit when they buy. Advertisements in newspapers, on the radio, and on television tell about all kinds of plans for using credit. They tell about the "pay as you go" plan, the "thrift plan," and the "pay out of your income" plan. The consumer is allowed to pay in "six months," "twelve months," "two years," and sometimes even "60 months." He is told about "carrying charge," "service charges," "interest rates," "discounted loans," and "add-on loans."

One may create personal financial problems unless he learns how to use consumer credit wisely. A way to reduce these sales terms to a kind of a common denominator is necessary to compare the cost of credit and to determine when and how much credit to use.

Deciding whether to use or not to use credit is, to a great extent, a personal matter. Families and individuals differ, but certain factors must be weighed in making decisions about using credit or serious financial problems may develop.

This bulletin gives information about the kinds of consumer credit in Oregon, sources for consumer credit, information about how to compare costs, and how to use this information to find the answer to the problem: "How much and when to use consumer credit?"

What Is Consumer Credit?

Consumer credit is a temporary substitute for cash. It enables a family or a person to get goods and services now with an agreement to pay in the future. Consumer credit is used to purchase consumer goods for family living and is repaid usually in from 1 to 36 months from the consumers' future wages or income. Oregon law defines consumer goods as "goods that are used or bought for use primarily for personal, family, or household purposes." A good credit rating is a personal asset. It is one of the most valuable personal possessions any one can have. A good credit rating means that the consumer has proved he can be trusted to keep his word in paying bills as agreed. Credit agencies simply record ratings; they do not make them.

A person's credit record follows him wherever he goes. There are more than 1,700 credit bureaus, all affiliated with the Associated Credit Bureaus of America. As families move from one community to another, their credit records follow them. So protect your credit records by paying all bills promptly as agreed.
Family Use of Consumer Credit

More than half of all the families in the United States use billions of dollars of consumer credit. At the end of 1963, families had $63.5 billion of consumer credit outstanding, not including home mortgages.

Consumer credit is used for the purchase of new and used automobiles and consumer goods and services, including furnishings and equipment for homes, travel for the family, repair and modernization loans for homes, and personal cash loans for a variety of consumer purposes.

Younger families are using more credit in relation to income than other families. They expect their incomes to increase in the future and are impatient to own the conveniences and durable goods they are accustomed to in their parents' homes. Records show too, that once having made the plunge, consumers in debt are better sales prospects; that is, they buy more on credit than nondebt families.

Reasons For Family Use of Consumer Credit

- Many families use charge accounts and service credit primarily as a convenience. Charge accounts save carrying so much cash or writing so many small checks.

- Some families use credit to meet emergencies that sometimes arise. Families with little or no financial reserves find that they must use credit at these times, although it is certainly more costly than using reserve funds.

- Using credit may be one way of forcing families to save. It may result in an increased standard of living through the purchase of durable goods—automobiles, appliances, or furniture.

- The impatience of consumers is another reason for using credit. Most people live in the present and they value present goods and services more highly than the possibilities of satisfaction in the future.

Dangers of Using Credit

Some families in the United States cannot seem to live without credit, yet they cannot seem to live with it either, at least happily. Financial problems are the single most important cause of anxiety and conflict between married couples. Marriage counsellors also blame money problems for the majority of the unhappiness they see.

- Families may be tempted to overbuy just because the paying seems so simple.

- Credit makes it easy for people to buy on impulse, frequently choosing something which really does not fit their needs or wants.

- Use of income becomes more rigid because some of the future income is already obligated to pay for credit.

- If a payment is missed, the borrower runs the risk of losing the goods.
Various Types of Credit

Noninstallment Credit

Charge account and service credit are expected to be paid in full in approximately one month without service charge. Charge accounts are a service of many retailers. Service credit is offered by utility companies and by many doctors, dentists, and service businesses, such as dry cleaners.

Revolving credit is extended by retail stores and has many variations. Generally, a customer is extended credit for a predetermined limit with a service charge on the unpaid balance. The service charge is usually 1 1/2% per month on the unpaid balance, or an annual interest rate of 18%.

Revolving check credit is extended by some banks. Credit is established with a special checkbook and the writing of the check creates the credit. The terms usually include definite requirements for repayment; plus a service charge of 1% monthly.

Charge account banking, another service of some banks, permits a customer to buy on credit at a large number of stores. The merchant pays the bank a service charge on all charge sales plus an entrance fee to belong to the plan. The consumer pays no service charge to the bank if he pays his bill within 10 days of receipt. Or his terms may include a partial repayment with a charge of 1% a month on the balance outstanding.

Credit card systems are for charge account credit, usually for 30 days. The card authorizes the extension of credit to the holder for services and goods. Some credit-card systems require no fee or dues; for example, those of oil companies, railroads, and telephone companies. Others require the holder of the card to pay a deposit; for example, the airlines. There are also various multi-service credit card plans. Some require a membership fee from the user and a percentage on credit-card purchases from the participating business.

Special credit plans for teenagers are sometimes provided. Much has been said and written about the advisability of charge accounts open to teenagers. Most of these accounts require parental approval and some require guarantee of payment by parents. Such accounts are usually limited in the amount of credit allowed.

Installment Credit

Installment purchase or sales credit is a longer term consumer credit and is used more extensively than any other kind of consumer credit. About one-fifth of all retail sales are made on the installment plan. It differs from charge accounts in that a contract is signed before the goods are delivered, and the seller in many cases retains title to the goods until the final payment is made on the contract. Payments of a set amount are made each week or month for a specified length of time. A carrying charge or interest is added to the cost and is payment for use of the money that is involved in the transaction. Length of time for installment contracts for consumer goods is usually less than 24 months. However, automobile credit now is being extended for longer periods of time—36 to 48 months and in some cases for as long as 60 months.
Many families consider installment buying as "forced budgeting" because it forces them to pay a certain amount each month in order to keep the articles they have purchased on credit. Installment buying may make it possible for families to have things for the home and to pay for them while they are enjoying their use, but installment credit also obligates a part of a family's future income for the length of the contract.

An installment purchase credit contract is signed. This is a legal document describing the rights and responsibilities of both the lender and the debtor. Your signature on a contract indicates that you know, understand, and agree to the terms of the contract. Be sure you do before you sign it. It is a legal contract and can be collected if necessary through legal channels.

Never sign a contract with blank spaces that are to be filled in at a later time. Find the answers to these questions before you sign:

1. Are there extra charges for late payments? If so, how much?

2. What security are you pledging when you sign the contract or note? Personal property? Automobile? Wages?

3. In event that payments are not made and articles must be repossessed, will you be given fair notice? Will you get money back if the item is resold for more than the unpaid balance? Will you be responsible for legal and other costs involved in repossession?

4. What are the financial terms of the contract including: (1) the cash price of the merchandise, (2) the down payment to be made, (3) the amount of the loan, (4) the cost of insurance (life and/or health and accident), (5) other costs—filing or recording, (6) the credit charge or interest rate in dollars and cents, (7) the amount of the contract balance. How much are you paying in total? and (8) the number, amount, and date of installment payments.

5. If payment can be made before the final date of the contract, what part of the credit charge or interest will be refunded to you?

**Rebates on Prepaid Loans**

Installment contracts are written to include the amount of the loan plus the amount of interest or carrying charge for the entire period of the loan. When payment of the loan is made in advance, the unearned charge usually is refunded to the borrower. This is known as a rebate. There are several methods for determining the amount of rebate. The amount is based on both (1) the length of the unexpired loan period and (2) the amount of the outstanding balance that is prepaid.

For example, an installment contract for $1,000 is to be paid in 12 monthly payments and the charge is 6% add-on interest. This would mean that total payments would equal $1,060. If the loan is repaid in six months, the amount of rebate would be 21/78 of the $60 carrying charge or interest (27% of $60). If we consider the fact that the first month under the loan the borrower would have the use of all twelve monthly payments, the second month only 11, and each month he would have the use of one less monthly payment or unit, in total he would have the use of 78 monthly installment units. If the loan is repaid in six months, at this point the total installment units in the remaining six months would be 21 (6 + 5 + 4 + 3 + 2 + 1).
Actually the borrower has the use of a smaller and smaller amount of money each month and the rebate is determined on the basis of the interest or carrying charge for this smaller amount, not on the total amount of the loan.

**Cash Loans**

The average consumer has a variety of possible sources for borrowing money—money that can be used for purchase of articles for the home, to consolidate other outstanding debts, or to meet emergencies. You need to consider all of the possible sources available to you and to determine which of these lenders is best for your specific purpose.

Some of the sources of cash loans are:

1. **Commercial banks** extend their lending services to the consumer either through a regular loan department or through a personal loan department. Banks usually make loans to their customers or persons that they know. They are more conservative in their attitudes toward risks. If you qualify for a bank personal loan you will probably pay a lower cost for credit. Commercial banks are one of the largest sources of funds for personal loans, and they make both secured and unsecured loans.

   Repayment can be made by a single payment or by installment contract. Charges for the banks are subject to general laws of the state relating to interest and usury. This means a maximum rate of 8% discounted per year on loans under $500 and 10% simple interest per year on loans over $500.

2. **Credit unions** provide personal loans, but the service is restricted to members of the credit unions only. Credit unions are voluntary cooperative saving and loan associations and are organized within definite groups. Their aim is to render service to the membership rather than to make a profit. Credit unions may be federal or state chartered, and maximum rates that can be charged are determined by their charters. Federal-chartered unions cannot charge more than 1% per month on the unpaid balance of the loan. The same is true of Oregon chartered unions. Repayment of loans is usually made by installment payments.

3. **Consumer finance companies**, sometimes called small loan companies, are in business expressly to make personal or consumer loans. They make both secured and unsecured loans, but their lending policy is somewhat more liberal than other organizations. To compensate for the risks they assume, cost of doing business, cost of borrowed capital, and other expenses, their rate of charge is usually somewhat higher. The Oregon Consumer Finance Act of 1955 regulates the rate of credit charges that they can make. The Act provides for a maximum rate of 3% on the unpaid balance to $300; 2% on the part of the loan in excess of $500; and 1% on the part of the loan in excess of $500 but less than $1,500. These are per month rates on the unpaid balance.

4. **Life insurance companies** will make loans if you use your life insurance policy as a collateral (when the policy has been in effect long enough to accumulate a “cash or loan value”). The rate of interest is stated in the policy, and the amount of the loan is limited by the loan value of the policy. The rate of interest is usually lower than most other sources. One caution,
however: the loan reduces the value of the policy by the amount of the loan until it is repaid.

5. **Pawnbrokers** are one of the oldest sources of cash. They advance money in exchange for personal property left with them as security. These items will be returned to the owner upon payment of the amount advanced plus a stated cost.

6. **Individuals**, friends, and relatives often extend cash loans. Repayment terms and charges vary, depending upon the situation.

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**Cost of Credit**

Credit is a service offered the consumer by retailers and lending agencies. Cost for credit varies widely in Oregon as interest rates may vary from 6% to 36% per annum. Any retail establishment or lending agency which extends consumer credit has to meet the expenses of offering the services. Part of this charge is "interest" on the use of money. But there are other costs involved in doing credit business—credit investigation, record keeping, collection, and credit losses. The finance or carrying charge pays for these services.

**Why Do Costs Vary?**

Too often the user of consumer credit is interested in only two things: (1) What is the down payment? and (2) What are the monthly payments? They need to be concerned, too, with what costs are involved. Costs for credit vary from lender to lender and the factors that affect these costs are:

1. **Type of lending agency.** Some lenders are selective and lend only to consumers with good credit ratings; others taking greater risks must charge higher rates of interest.

2. **Size of loan.** It costs as much to process a small loan as a large one; consequently, interest rates or carrying charges are higher on small loans.

3. **Length of repayment period.** The longer the repayment period to discharge the debt, the greater the cost to the borrower.

4. **Consumer's credit rating.** Persons with poor credit ratings are often forced to pay higher rates of interest.

5. **Added service charges.** In addition to the interest rate, lenders frequently require insurance to protect their investments. Some add credit investigation charges to the cost of credit.

6. **Type of loan.** A collateral loan carries a lower rate of interest than an unsecured loan. Interest rates on new merchandise are lower than on used merchandise or other durable goods.

**How to Compare Credit Costs**

The consumer needs to determine the cost of installment credit. What will it cost him in terms of dollars and cents?

*The dollar cost will help you decide whether the use of credit in a given situation is worth the expense it involves. The dollar cost of credit in an installment purchase is the difference between the cash price and the "time
price.” Or, a borrower may borrow $1,000 cash from a lending agency and pay back a total of $1,060.50. The dollar cost of this loan is $60.50.

The consumer also needs to know what this charge represents in terms of an annual percentage rate or annual interest rate. This is a way of accurately comparing the rates charged by the various sources of credit.

To convert finance charges into an annual interest rate, the consumer needs to know:

- The amount of the finance charge. This may be stated; if not, it can be figured as the difference between the total of all payments and the cash price.
- The amount of the loan or credit extended.
- The period over which you must pay off the loan.

There are several methods of computing the “annual interest rate,” and this is one formula that can be used to compute the annual cost rate of cash loans and installment purchases.

Annual interest rate = \[
\frac{2 \times \text{number of payments} \times \text{total finance charge}}{\text{Total amount financed} \times \text{Total no. of payments you will make} + 1}
\]

For example, let us see how this formula can be used in determining the interest rate on an installment purchase. For example, the dealer says the price of the refrigerator is $240. He requires a down payment of $30, and the balance can be paid in 12 monthly payments of $19 each. You are borrowing $210 from the dealer and this is the amount that you use as the total amount financed. In 12 monthly payments of $19 each, you will pay back $228; this means a finance charge of $18. Now, using these figures in the formula you can determine the true annual interest rate.

\[
\frac{2 \times 12 \times 18}{210 \times 13} = \frac{432}{2,730} = 15.8\%
\]

Methods of Stating Interest

The interest rate is the price paid for the use of credit. There are three methods commonly used to state credit charges.

Add-on interest. The interest is calculated and added to the loan. The total is then divided into even monthly payments.

Interest in advance or discounted. The finance charge is computed on the total loan and deducted to determine the amount the borrower will receive. The borrower repays the total amount.

Interest on the unpaid balance. The interest rate is usually expressed as a monthly charge. At the time the payment is made, the finance charge is computed on the unpaid balance.

In comparing the costs for these methods of stating charges, with the add-on interest and interest-in-advance methods, the borrower does not have full use of the total sum for the entire period. Each month the sum in use is smaller by the amount of payment. A quick estimate of the true interest is almost twice the stated rate. A quick estimate of the true annual interest rate of the interest on the unpaid balance is to multiply the stated monthly rate by twelve.

To illustrate the difference in true interest rates, a $300 loan to be paid
back in 12 monthly payments as calculated for the different methods would be:

**Add-on interest** at 6% would cost the borrower $18. The total to be paid back would be $318 or $26.50 monthly.

$$A.I.R.* = \frac{2 \times 12 \times 18}{300 \times (12 + 1)} = 11.08\%$$

* Annual interest rate.

**Interest in advance** at 6% would cost the borrower $18; the total to be paid back would be $300 or $25 monthly. However, in this case the borrower would have the use of $282.

The wise consumer will control his use of credit rather than be controlled by it. Credit needs to be used in moderation and not be abused if it is to benefit the family. The amount of credit a family can use safely depends on current income level, income prospects, size of family, thrift habits, and other family characteristics. Each family is somewhat different from other families.

Every once in a while a financial adviser will come up with a formula to help families determine what percentage of their income can be used for credit. For example, some professional credit men say that the average family can assume obligation for consumer credit up to 12% of its monthly take-home income, with 1% deducted for each dependent. Others suggest that a family should not owe more than 10% of a year’s take-home income for installment credit.

The only way a family can determine how much credit it can use safely is to first learn how to make an accurate, sensible family spending plan. A family spending plan will show the amount of money the family needs for its necessities — food, clothing, and shelter; it will show the amount of money necessary for other commitments the family has made for maintaining its standard of living.

**How to Use Credit Wisely**

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**Some Rules to Consider**

1. **Be sure that the ordinary use of the article being bought will last beyond the time the last payment is made.** Do not let the installment debt run so long that the enjoyment of "having it now" wears off before the debt is paid.

2. **Make as large a down payment as possible without upsetting the family budget.** It is wise to be sure that the debt is no larger than the resale
value of the article purchased. Some good guides are to pay down one-third the purchase price of an automobile and one-tenth the price of equipment and furniture.

3. Pay off the debt as quickly as possible within the limits of your income. Try to limit installment credit to not more than 24 months.

4. Buy only on sound credit terms. Shop for the best sources of credit in the same way you shop for the best buys in food or clothing. Credit costs can vary among lenders and dealers, so you need to compare the various costs for credit and the services that you get from the lenders.

5. Protect your credit rating. Be sure to make payments promptly. Should it be necessary to postpone or reduce payments, call the credit manager immediately and explain the situation so that plans can be made concerning your payments.

6. Hold the use of consumer credit to a safe percentage of your income. Each individual family has a definite percentage of disposable income that should not be exceeded, and only with family planning can this be determined. Families need to determine what amount is needed for their living expenses and for saving for the future. It is the income that is left, called "discretionary income," that can be considered when deciding upon the amount of credit that can be used.

7. Know what it costs to use credit—both the dollar costs and interest rates. Only when you know the costs can you decide if using credit is really "worth it." Costs for credit vary. Compare the costs of consumer credit.

8. Understand the contract or note you sign. When you sign the contract you indicate that you understand and agree to its terms.
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