Using Credit Wisely - the 20/10 Rule

Types of Credit

Single-Payment Credit

Pay in a single payment within a given time period

Examples: Doctors, utilities, paycheck lenders

Installment Credit

Pay in two or more regular payments of a set amount

Examples: Cars, mortgages, furniture, vacations

Revolving Credit

Buy within a credit limit – minimum due regularly

Examples: Retail charge accounts, credit cards

Credit Reports

- Record of your credit history
- Three credit bureaus: Experian, Trans Union, & Equifax
- Can affect: purchase power, job, and even insurance rates
- Having multiple credit cards with open lines of credit will reduce your credit score (For every credit card a person has, the maximum credit amount appears as "accessible open credit" on your credit report, and increasing the amount of "accessible credit" by acquiring additional credit cards will cause your credit score to go down. This provides a warning to a potential lender that you might not be a good candidate for a loan.)

How Much Can You Safely Borrow?
(The 20/10 Rule)

20: Never borrow more than 20% of yearly net income*

10: Monthly payments should be less than 10% of monthly net income*

*the 20/10 rule does not apply to home mortgages

20/10 Rule Practice Problems

Using the 20/10 Rule for calculating responsible credit (safe debt load):
If your net income (money after taxes) is $1000 a month, then your annual net income would be _______________.

1. Calculating 20% of your annual net income to find a safe debt load, would going into debt to finance a vacation cruise costing $2,500 be considered a safe debt load? Why or why not?

2. Assuming your income (money after taxes) is $1000 a month, would it be a responsible credit (safe debt load) to purchase a new High Definition TV with monthly payments of $90? Why or why not?