Credit cents

# Finding the Right Loan or Credit Card

Whether they're looking for a mortgage, an auto loan, or a credit card, smart consumers comparison shop for credit because it can save them money. Before you open a credit or charge card account or sign a loan agreement, compare offers from several creditors. Become familiar with the terms financial institutions use so you'll know exactly what you're agreeing to.

## Types of credit accounts

**There are two basic types of credit accounts:**

- Closed-end accounts extend you a specified amount of money over a set period of time. The payment period, payment amount, and number of payments remain fixed for the life of the agreement. You can't add more purchases or loans to the original balance. Consumers often use this type of account when buying vehicles, major appliances, and homes as well as for some personal loans.
- Open-end accounts let you make repeated purchases or get cash up to a specified limit through an ongoing agreement with the creditor. Some agreements require that you pay off the full balance each month. Others let you make a minimum monthly payment, adding a finance charge for interest and other fees to your balance. Examples of open-end credit include revolving charge accounts, credit cards, lines of credit, and checking accounts with overdraft protection.

## Credit card vocabulary

It's important to become familiar with the terms used by credit card issuers and to always read the fine print before signing up for one:

- **Annual fee:** Most credit cards don't impose annual fees. If you can, avoid those that do.
- **Annual percentage rate or APR** (the percentage you pay, per year, in interest and fees): Look for APRs near or below 12 percent. Beware of deceptively low intro ductory APRs that will increase significantly in a few months.
- **Application fee:** Most credit card issuers don't charge fees to open accounts.
- **Fees for cash advances and balance transfers:** Does the issuer charge fees for these services? How much are they?
- **Fixed vs. variable APR:** An issuer can raise a so-called "fixed" interest rate with as little as 15 days notice to cardholders. Make sure you know if the APR is truly fixed or if—and how often—it can change.
- **Grace period:** How much inter est-free time do you have between the day you make your purchase and the day your payment is due? The best cards offer at least 25 days.
- **Late payment fee:** How much extra must you pay if your pay ment is late? Shop for a fee that's $20 or less.
- **Leniency period:** How much time do you have between the day the payment is due and the day a late fee is assessed? Look for a card that gives you breathing room of three to five days.
- **Minimum payment allowed:** A minimum monthly payment of 2 percent of the balance may sound attractive to you, but beware! As you can see from the chart below, you'll pay more in interest as you take longer to pay off the current balance.
- **Over-the-limit fee:** Is there a fee if you exceed your credit limit?
- **Penalty APR:** Will the APR increase if you're late or miss a payment? Avoid cards that assess penalties. If you must use one that does, select one with a penalty APR of 20 percent or less that's assessed for only a limited period, such as until you make two on-time payments in a row.

**Also beware of traps that can drive up the cost of using credit:**

- **Hidden transaction fees:** Does the company charge for cash advances, balance transfers, and

**How a small payment will cost you money in the long run**

| Beginning balance | APR | Monthly payment | Months to pay off balance | Total interest paid |
|---|---|---|---|---|
| $2,000 | 15.0% | 2% | 169 (14 yrs) | $2,205.63 |
| $2,000 | 15.04% | 5% | 65 (5.5 yrs) | $589.74 |
| $2,000 | 15.04% | 10% | 36 (3 yrs) | $269.31 |

**Source:** A Road Map to Avoiding Credit Card Hazards, Consumer Federation of America, 2001.

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quasi-cash transactions like lottery ticket purchases?

- **"Bait-and-switch" offers:** If you don't qualify for the company's premium credit card, will you automatically be switched to a lower-grade card that costs more and offers less attractive terms?
- **"Tiered" pricing:** Does the company offer you a range of APRs? This can work against you if the company bases your APR on your credit history and inflates your rate accordingly.

## Choosing a credit card

The average household gets eight credit card offers each month. Before you accept an offer, decide how you would use the card and what you would buy with it. Do your homework to make sure you're getting the best deal. Many card offers advertise low introductory rates or other benefits if you accept "before the offer expires." While low introductory rates may sound good, they often increase steeply in three to six months or apply only to the balance you transfer from another card. Regardless of the rate, don't charge too much on your new credit card until you get comfortable with the monthly bill.

The credit card comparison chart at right will help you choose the best card for your money and for your individual needs. Examine costs and terms, and think about your typical bill-paying behavior. Do you pay your outstanding balance in full each month? Or do you usually carry over a balance and run the risk of paying interest on your interest? Matching the credit card plan to your needs could save you money.

## Paying on closed-end credit

If you're paying on closed-end credit, consider the time period for repaying the debt. How long you take to repay a car or home loan is an important decision. As you can see from the chart above, the more time it takes, the more it will cost you. If you borrow $4,000 at an APR of 12 percent for two years, your total interest cost will be $519. If you repay the same amount, at the same interest rate, over four years, your total cost for using this credit will jump to $1,056! Of course, your monthly payments will be lower over four years—$105 instead of $188—but you'll need to decide if the lower monthly payment is worth the extra interest. Try to make the largest payment you can for the least amount of time.

Although using credit is convenient, be sure you understand what you're agreeing to and how much it will cost you in the end. Saving for purchases is the least costly option, but if you decide to use credit, shop around, find the best terms available, and be familiar with your financial picture (see Credit Cents no. 6, *How Much Debt Is Too Much?*) Never spend more than you can repay.

**How paying off a loan quickly will save you money in the long run**

| Loan amount | Interest rate | Time | Monthly payment | Interest paid | Total cost |
|---|---|---|---|---|---|
| $4,000 | 12% | 2 years | $188 | $519 | $4,519 |
| $4,000 | 12% | 4 years | $105 | $1,056 | $5,056 |

**Source:** A Road Map to Avoiding Credit Card Hazards, Consumer Federation of America, 2001.

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**Comparing credit card offers**

| | Credit card #1 | Credit card #2 | Credit card #3 |
|---|---|---|---|
| Name of issuer | | | |
| Annual fee | | | |
| Annual percentage rate (APR) | | | |
| Application fee | | | |
| Cash-advance fee | | | |
| Other transaction fees | | | |
| Fixed vs. variable APR | | | |
| Grace period | | | |
| Leniency period | | | |
| Late payment fee | | | |
| Minimum payment allowed | | | |
| Over-the-limit fee | | | |
| Penalty APR | | | |
| Benefits (points earned etc.) | | | |
| Credit limit | | | |