Using Credit: Types, Terms and Tips!

During this week’s #FinancialEdFriday we’re diving into all things credit. In this post you’ll find insight into the primary types of credit, common terms, and some helpful tips.

**Types of Credit**

There are three common types of credit that can be used for different types of purchases.

Revolving Credit: Make a single or multiple charges up to the credit limit established at account opening. As you pay down the balance the funds become available again for your use.

Example: Credit cards.

Installment Credit: Borrow a specific dollar amount and repay in equal installment payments for the term of the loan, (48 months, 60 month, etc.).

Example: Car loans, mortgages, and student loans.

Open Credit: When you use a service and then pay for it later. This type of credit does not report to the credit reporting agencies unless you do not pay them and they are sent to a collection agency.

Example: Utilities and phone bill.

**Common Terms:**

Whether you’re new to credit, or have been using credit for years, there are several terms used that can get confusing. We have broken them down for you:

Annual Fee: A once a year fee charged on select credit cards, even if you don’t use it.

Credit Limit: The maximum dollar amount you can borrow. Credit limits are established when you open an account and may vary. Different credit cards may have different limits.

Credit Score: A number rating between 300 and 850 that shows your “creditworthiness” or how likely you are to make a payment, bill, etc. on time.

See our blog post for more: <https://aagcu.org/2024/03/01/credit-basics/>

Default: The failure to make your required payment on a debt. This is a serious situation that can cause damage to your credit score if repayment is not continued.

The lender could demand you immediately repay the total outstanding balance, which is called accelerating the debt.

You can be sent to collections, where the lender utilizes a third-party agency to obtain the money from you.

Down Payment: An amount of money you pay up front when taking out a loan. This money goes toward the overall cost of the item and helps lessen the amount of money needed to borrow.

Finance Charge: A fee charged for obtaining credit. This is typically a percentage of the amount borrowed. The most common type of finance charge is interest.

Grace Period: The amount of time before interest begins accruing on a loan. This process varies between the form of credit used:

Grace period for Revolving credit (credit cards): The amount of time you must pay off the borrowed money before interest begins accruing or make the minimum payment to avoid fees.

Grace period for Installment loans: The number of days after the due date a payment can be made without being charged a late fee.

Interest Rate: A percentage of the borrowed money that must be paid back to the lender on top of what was borrowed.

Minimum Payment: The lowest amount you can pay back on a loan by a specific date to avoid additional fees.

Principal: The amount borrowed for a loan.

Term: The length of time you have to pay back the money borrowed and interest that may have accrued.

**Tips and Tricks**

Building credit takes time and consistency. There isn’t one answer on how to improve your score, but there are some habits you can implement to help along the way.

Paying your bills/debts on time is one way to improve your score. Doing what you can to avoid late fees or missed payments will, overtime, show the credit bureaus you are consistent and reliable with your payments.

It might be daunting to use your credit accounts, but having light, regular use is important for improving your score. Using your credit card for one small purchase a month, emergencies or a planned expense is an effective way to maintain consistent usage. Be sure to pay it off immediately or as soon as possible to avoid interest.

Another good rule of thumb is to understand your credit limit on each account. Though you may have a thousand dollars as your credit limit, it doesn’t mean you should be using it to that extent every month. Keeping the balances lower will help you grow your credit score faster. It’s recommended not to exceed 30% of your credit limit, but the lower the better. This shows the credit bureaus you aren’t relying on credit as much and puts you in a better position to pay off your debt each month.

When making a large purchase, like a car or a house, aim to pay at least 20% of the total as your downpayment whenever possible. The larger of a downpayment, the less you need to borrow.

If you’re considering taking out a loan, AAGCU can help you! Our loan department will work with you directly to understand your financial goals and help you along the way. Email the loan department at loans@aagcu.org or call 206-824-9800 (option 1 for loans) to get the conversation started.

Keep an eye out for more #FinancialEdFriday’s throughout March!

**Questions?**

If you have any questions, feel free to contact us at (206) 824-9800 or by email at info@aagcu.org.