Financial Fitness

Activity: Managing Credit Card Debt

WORKSHEET

INTRODUCTION

Knowing how to manage your credit well is essential to financial stability. In this exercise you will learn about Amy, a college graduate, and the financial decisions that she makes. After reading about her financial behavior, determine whether each decision made a positive, negative, or no/minimal impact on her credit.

IMPORTANT FORMULAS

Calculating Simple Interest

$$A = P * (1 + (R * T))$$

Calculating Compound Interest

$$A = P * (1 + R)^{T}$$

KEY TERMS

APR: Annual Percentage Rate

CLR: Consumer Leverage Ratio

A: New Amount

P: Initial Amount (Principal)

R: Annual Interest Rate

T: Time In Years

Q1: Below we have compiled a list of financial decisions, social behaviors, and savings plans that Amy may have made. Your job is to figure out the impact these behaviors will have on Amy's credit. Please write if the impact on credit was "GOOD", "BAD", or "NONE." Beware of some trick questions!

Amy's Behavior	Impact
Amy's been using her credit card for the last four years and has always made her payments on time. Sometimes she pays the full amount, but she always pays at least the minimum.	
Amy applies for a new credit card with a higher limit which she can afford, increasing the number of credit cards which she currently has.	
She applies for a job as a nurse at the local hospital. As part of the process, they order a credit report on Amy. She gets the job!	
She finds an apartment, and her landlord orders a credit report to check if she can consistently afford the rent and mortgage.	
Amy's excited about her new apartment and buys all new furniture, pushing her credit card over its limit.	
She buys new outfits for the weekend and maxes out 3 of her 4 credit cards.	

Amy struggles to make her many credit card payments, along with meeting her rent. She's late on two of her credit card payments.	
Amy's car breaks down, and she decides to buy a new one. The car dealer turns down her request for a loan due to poor credit.	
Amy seeks help from a reputable local nonprofit credit counseling agency.	
Amy sticks to her spending plan and meets all her minimum payments; but she rarely is able to pay more than the minimum amount.	
Amy cancels three of her newly acquired credit cards and learns to use her remaining credit cards only when she really needs them.	
Amy continues to use one or two credit cards, but she always makes at least the minimum payment. She tries to pay off her card completely if possible	

CLASS ACTIVITY

After graduation, Amy has been having a hard time lately with her finances and incurred $1000 in credit card debt. Her credit card company only requires a minimum payment of $25 a month but charges him a 15% interest rate on her debt.

He only makes minimum payments of $25 per month, instead of paying down the $1000 in debt. Let's check out how her debt changes with time:

Q2: Which of these are a good credit score?
A: 400
B: 675
C: 710
D: 730
E: 895

Q3: Comparing the APR among several credit cards allows you to obtain the:
A. lowest grace period
B. lowest annual fee
C. lowest interest rate
D. least expensive method of calculating interest

Q4: Why is it important to understand the APR associated with a new credit card?

Q5A: You owe $2,500 in credit card debt which has a 25% annually compounding interest rate. How much will you owe in 5 years?

Q5B: What amount of the debt in Q5A after 5 years is interest? And how much of the debt is the initial principal?

Q6: You get your monthly credit card statement and are offered the option of making a minimum payment of $15 per month. If the credit card company charged you NO interest (which would never happen!) How many months would it take you to pay off the $1,000?

Q7: What are some of the benefits of paying off a credit card quickly?

Q8: How might paying extra money each month affect the time it takes to pay off your purchase? Write 2-3 sentences to help show your thinking.

INSTRUCTIONS
The following 2 questions will help you further understand consumer leverage ratio, known as CLR. This is an important ratio that measures the amount of debt you hold in relation to disposable income. It is calculated by dividing your total debt by disposable personal income. Please use this formula for the following questions. A good CLR ratio is between 10% and 20%. Anything near 30% is considered financially dangerous.

Q9: Say you make $90,000 and, after taxes and expenses, you have $35,000 in disposable personal income. If you have $1,000 in total debt, what is your CLR?

Q10: Is the CLR you calculated above, good or bad? Write 1-2 sentences explaining why.

Q11: Using the example in Q9, if you have $20,000 in total debt instead of $1,000, what is your CLR? Is this better or worse than the previous example?

Q10: Jessie has a monthly net income of $800. Her fixed monthly expenses consist of $150 for rent. He currently pays $80 each month to pay off her entire credit card bill, and now he wants to buy a car. What does Jessie have left in her budget for a car payment to stay within her safe debt load (20% CLR)?