Understanding Credit

Having credit can be a beneficial tool that can help you reach your goals, build healthy financial habits and help you prepare for unexpected and costly life events. As with anything in life, moderation is key and credit should be used wisely and with caution.

What is credit?

Credit is when a lender (usually a financial institution) gives a borrower access to funds, under the promise that the borrower will pay it back as per specified payment arrangements and terms. There is a cost to credit – the lender will charge the borrower interest or service charges depending on the agreement. Common types of credit include installment loans for large purchases such as a home or a car, as well as revolving credit arrangements such as credit cards and lines of credit.

What type of credit is right for you?

As a consumer, you have a number of different credit options available to you, and you must decide which one makes sense for your financial situation.

Consumer loan

Also known as a personal loan, these are used for a variety of major purchases, with the exception of buying a home. A personal loan can be taken out to assist with the purchase of a car, home appliance, a vacation or home renovations.

Mortgage

A mortgage is taken out to assist with the purchase of a home. A mortgage is one of the longest credit commitments most people make in their lives. The life of a mortgage (also called the amortization period) can be anywhere from a few months to 30 years. Mortgage repayments can be made on a weekly, bi-weekly or monthly basis, and some mortgage agreements include periodic opportunities to pay back a lump sum of the mortgage without penalty.

Credit card

Credit cards can be issued by a number of different institutions and can be used to purchase every day and one-off goods and services and cash advances. If you don't pay back the full amount owing on the credit card on a monthly basis, you will be subject to interest payments on top of your purchase price.

With a credit card, there is a minimum monthly payment that you must pay each month to maintain your credit rating. If you can manage it within your budget, you should always pay more than the minimum in order to pay down credit card debt (which often has a high interest rate) faster. Ideally, you should pay off your balance in full every month.

Credit can help you reach your goals

Lines of credit

A line of credit is a revolving loan that lets you borrow up to a certain approved limit. You only pay interest on the amount that you have used and the interest rates are generally lower than credit cards. Lines of credit are handy to have for emergencies, and paying off higher interest credit cards. A credit line can also offer protection against overdrawn accounts.

Loan security

In some cases, depending on the amount you're looking to borrow and your credit rating, you will be required to pledge an asset as collateral for the loan. Loan security mitigates the risk for the lender and you benefit from a higher loan amount and lower interest rates. There are two main types of loan security:

1. **Personal property security**
   Personal property is defined as tangible and

moveable property. Items such as cars, boats or other highly valued goods can be used to provide security for loans. If you default on a loan that has personal property security attached, the lender can take possession of this property.

2. **Collateral real estate mortgage**
   A collateral mortgage is a legal contract registered against the title of your home; using your home as security. With a collateral mortgage, the borrower is obligated to pay back the funds in a predetermined set of payments.

Finding your balance

In order to help determine how much credit you can afford, our team of advisors use financial ratios to determine member's ability to pay back financial debt based on each individual client's income vs expenses on a month to month basis. Another guideline to follow is to only borrow what you need to make specific purchases and don't borrow as much as you can get.

To calculate how much credit you can afford, go through the following steps. A G&F expert can guide you through this process.

Step 1: Establish your financial goals
Create a savings and spending plan and establish your financial goals (short, medium and long term).

Step 2 : Income and expenses
Calculate your average monthly income and expenses.

Step 3 : Calculate your discretionary income
The difference between your income and your expenses is known as discretionary income. This is money that is available to you for saving, spending or making debt repayments.

Your discretionary income amount will determine how much credit you can take on.

Establishing and maintaining good credit is essential in using lending products. Keep your credit in good standing by honouring the terms of your agreements. Every form of credit you carry, regardless of the amount, is an important part of your credit history and can affect your credit rating.

Smart use of credit

Be wise about using credit and ask yourself the following questions:

1. **Do I really want or need this item, or am I buying on impulse?**
   Sometimes it is too easy to put a purchase on a credit card, even though it might be financially unrealistic. Stay mindful of how much you're spending and keep track of your purchases.
2. **How can I make important purchases and still save for my future?**
   Using credit, you can make the most out of your savings by putting them into high yield investment products to borrow from when important expenses come up. A line of credit can help you keep a healthy emergency fund that you can draw upon when needed.
3. **If I wait until I have enough savings to pay cash for an item, how much will the price increase?**
   If you're planning to buy a big ticket item, such as a major appliance, or a car, the price point often increases from year to year. If you're concerned about how much an item will cost by the time you save up enough cash to purchase it, consider a loan to buy the item sooner rather than later. This is a valid option only if your budget can handle the loan repayment options.
4. **If I am making a long-term credit commitment, how secure is my current financial situation?**
   Most people can only make large purchases, like a home or car, if they take out some kind of loan. Before committing to this type of purchase, make sure your budget has some breathing room built in. It is smart to put money aside on a monthly

basis into an emergency fund so that you are still able to manage your loan repayment obligations if your employment situation changes.

Applying for a loan

Before you begin the process of applying for a loan, it's important to run through an assessment of your financial situation to determine how much you want to borrow and how much you can afford to pay each month. These numbers will be important factors as you go forward in this process.

Once you're ready to apply for a loan, here is a list of the financial information you'll need to have ready:

- **Your assets**
  includes items such as cash on hand, savings, investments, home, other property, vehicles, personal effects, etc
- **Your liabilities**
  includes items such as personal loans, credit cards, mortgages, unpaid bills, etc
- **Your net worth**
  this is your assets less your liabilities

Before you sign for a loan, ask questions!

You'll also be asked questions about your employment status, your family and your financial situation, including possibly personal questions about the number of dependents in your family, your spouse's income, etc.

These questions may seem intrusive but they are necessary for the lender to get a complete picture of your situation and assess your ability to financially handle the loan repayments before the application can go through.

Asking the right questions

Before you sign on the dotted line for a loan, make sure that you ask questions and get clarification on the process and what is required from you. Here are some questions to get you started:

1. What is the annual interest rate?
2. Is the interest rate fixed or variable?
3. What will the monthly payment be?
4. For a variable loan, will the payment change with the rate change?
5. Are weekly or bi-weekly payment options possible?
6. When is the loan due to be paid in full?
7. Are there any fees for processing the loan?
8. Can I make extra payments on the loan without paying a penalty?
9. Is any security or collateral required for this loan?

After you have a thorough understanding of the terms and conditions, you'll be in a better position to decide if the loan is right for you.

Application approval process

Once the loan application is complete, it will take about three working days to review the information provided, run a credit check and determine your suitability to receive the loan. A credit check is when a lender checks your past financial behaviour using a credit checking company like Equifax Canada or TransUnion.

If you've never had a loan or credit card before, it can be difficult for lenders to establish your credit risk, since there is no track record available. With this in mind, if you're in this position and you anticipate needing a loan in the future (for a home or car), you might want to consider taking out a small loan to build credit history before you have the need for a larger loan.

What if the answer is 'no'

If you apply for a loan and it is not approved, it could be for any number of reasons, including:

1. Your debt ratio is already too high, meaning the ratio of debt you are paying compared to your income is high
2. There isn't enough security for the loan

If you aren't approved for a loan, consider it a learning experience and explore what elements you need to have in place for a future loan application to be successful. This might mean paying down current debt or taking on a co-signer.

What you need to know

The most important thing to remember when you are applying for a loan is that your agreement to borrow money from a lender is legally binding. It is up to you to make sure you fully understand your loan conditions and to make sure that you are fully prepared to make your loan re-payments on the schedule that you agreed to.

If, at any point, you can't make your loan payments, contact the lender immediately to work out a plan. It is easier and you are more likely to receive a favorable response if you are pro-active and contact the lender before the missed payment.

Making credit work for you

Because it is quite easy to access and attain personal credit, it is valuable to become familiar with how it works and how to remain realistic when applying for loans, lines of credit or credit cards. With a budget in place and a sensible attitude towards borrowing funds for specific purposes, credit can be a useful tool to help you achieve your financial goals.

Determine your credit needs

Before you commit to credit, it's a good idea to discuss your entire financial situation and determine how much credit you can realistically afford. Connect with us to set up a plan that's right for you. Visit us in-branch, call our Member Hub (604-419-8888) or book an appointment with an advisor online. (https://www.gffg.com/Personal/AboutUs/ContactUs/Financial/)