

Credit: Convenience with a Caution

Credit is handy, but it has some risks.

As you become financially independent, credit is likely to play a bigger and more important part in your economic life than it has before.

There's a lot that credit can do for you. If you need money—especially in an emergency—and you don't have the cash on hand, the immediate buying power of a credit card can be a lifesaver. And through longer-term arrangements like car loans and mortgages, credit makes it possible to pay for things you wouldn't otherwise be able to afford.

But there is another side to the story. Credit makes spending money easy—sometimes too easy. So you can get into credit trouble by spending more than you can easily repay.

THE BIG PAYBACK

The flip side of the buying power that credit gives you is that you've got to pay back the money you spend. As obvious as this might seem, it can be surprisingly easy to forget how much you've charged when it seems like you have free money at your fingertips. In return for the privilege of using credit, you're required to pay a **finance charge**. For credit cards, this means that **interest**, which is calculated as a percentage of the amount you owe, accumulates on any unpaid balance.

now, pay later" philosophy. The most basic—and probably the most common—example is the **cash float** that credit cards provide. A cash float is the time between when you buy something with credit and when you pay the card issuer for that item. For example, say you use a credit card to buy a compact disc online on October 10, and you receive a bill from your card company on November 5 that's due November 25. If you mail in a check to pay the bill on November 20, the check doesn't clear your bank until November 27, almost seven weeks after you spent the money.

CREDIT IS AS CREDIT DOES

You're probably already familiar with using credit. If you don't have a credit card in your own name—and most college students and recent graduates have at least one—you may have used a card linked to your parents' account.

And even if you haven't used a credit card or taken a loan, you've probably dealt with lots of transactions that work the same way.

Many meal plans and cards in school dining halls allow you to get food

on a daily basis and pay for what you've spent at the end of the semester or year.

The CD and video clubs you see in magazines give you a large number of discs or tapes at essentially no cost based on the agreement that you'll purchase full-priced items in the future.

Magazine subscriptions that offer "pay later" options agree to send you the magazines you want and let you pay later.



For loans, the finance charge usually includes fees for the cost of arranging the credit, as well as the interest expense.

The problem with finance charges is that you can end up paying considerably more than your purchase originally cost. And while many credit cards don't impose a finance charge if you pay back the credit you've used within a certain period of time, most loans and some cards start charging from the moment you start spending.

Each credit arrangement has its own particular features, but one thing is true in every case: The longer you take to pay back what you've spent, the more using credit will cost. Interest can build up amazingly quickly, especially on big balances. And if you miss payments, you run the risk of having to pay late fees—at \$25 or more a pop—and even ending up with a bad credit rating, which can make it difficult to get credit later on.



Here's a tip: Don't live off your credit cards. If you've lost your job or the job hunt isn't going well, it's better to take a loan from your parents than to charge your living expenses.

—Jeanette V., 27

GIVE YOURSELF A LITTLE CREDIT

If you don't have a lot of cash, being able to buy things on credit can be a big help when you're furnishing an apartment or buying clothes to wear to work.

Using credit can also make your daily life a lot easier. Most merchants require a credit card number to reserve a hotel room, an airline flight, or a car rental, and of course, having a credit card is a prerequisite for shopping by phone and over the Internet.

Credit also allows you to get the most out of your money over time by taking advantage of the classic "buy



Of course, you don't want to get overly aggressive. If you try to stretch the float to the limit, your payment may be late. That could cost you a late fee on top of a finance charge.

By allowing you to buy large items now while taking years to pay off the full price, credit arrangements like mortgages and car loans use this cash float principal on a larger scale. Only in this case, the float is known as **leverage**, or using a small amount of your own money to buy something of much greater value.