



PERSONAL
LOANS 101:
**UNDERSTANDING
YOUR CREDIT RISK**



Loans have some risk for both the borrower and the lender.

The borrower takes on the responsibilities and terms of paying back the loan. The lender's risk is the chance of non-payment.

Consumers can choose from several types of loans. As a borrower, you need to understand the type of loan you are considering and its possible risk. This brochure provides information to help you make a smart choice before applying for a loan.

It is important to review your financial situation to see if you can handle another monthly payment before applying for a loan. Creating a budget will help you apply for the loan that best meets your present and future needs. For an interactive budget, visit www.afsaef.org/budgetplanner or www.afsaef.org/personalloans101.

You will need to show the lender that you can repay what you borrow, with interest. After you have made a budget,

**CONSIDER
THESE FACTORS,
WHICH MAY
REDUCE OR
ADD RISK TO
A LOAN.**



ABILITY TO REPAY THE LOAN

Is the lender evaluating your ability to repay the loan based on facts such as your credit history, current and expected income, current expenses, debt-to-income ratio (your expenses compared to your income) and employment status? This assessment, often called underwriting, helps determine if you can make the monthly payment and raises your chances of getting a loan to fit your needs that you can afford to repay. It depends on you providing complete and correct information to the lender. Testing “your ability to repay” and appropriate “underwriting” reduces your risk when taking out any type of loan.



CREDIT REPORT CHECKED

Did the lender check your credit report when you applied for the loan? Your credit report details your credit history as it has been reported by lenders who have given you credit. Your credit report lists the types of credit products you use, how long your accounts have been open, and if you have paid your bills on time.

Knowledge of your current payment practices and payment history helps predict how likely you will be able to repay a loan and make payments on time. It helps if the lender has a clear picture of your finances. Your credit report helps complete this picture.

In general, consumers who have a history of paying their bills on time are considered good credit risks and have higher credit scores. A credit score summarizes your credit risk based on the information in your credit report. Lenders use credit scores to help evaluate your credit report and estimate your credit risk.

You can get a free copy of your credit report every 12 months by calling 1-877-322-8228 or going to www.annualcreditreport.com.



EMPLOYMENT VERIFIED

Was your employment checked, either by contacting your employer or looking at your recent pay stubs? This confirmation provides the lender with up-to-date information on your job stability and monthly take-home pay. Proof of your work history can help you get a good loan and reduces your risk.



MONTHLY PAYMENTS AND TERM

Are the monthly payments equal or can they change each month? Is the loan for a fixed period of time (weeks, months or years), known as term?

Installment loans are for a set number of months and have a fixed interest rate and fixed payment. These fixed-rate loans have a fully amortizing payment, which means you pay off the debt in regular installments over a period of time. You make equal monthly payments of the principal balance plus interest until the loan is paid in full. Having a set monthly payment amount helps you decide, based on your budget, if you can afford the loan and also reduces your risk.

Credit cards give you a line-of-credit or credit limit that can change based on your cash advances and how much you spend. This “revolving credit” also means that the payment due each month will change based on how much of the credit limit you use.



BALLOON PAYMENTS

Some loans feature a balloon, or large, one-time payment due at the end of the loan term. You must determine if you can make the balloon payment when it is due. Before taking out a loan with a balloon payment, you should ask yourself if your paycheck, tax refund or other income will cover the balloon payment on its due date, in addition to your other monthly bills. If the answer is no, you should look for another type of loan. A balloon payment loan increases your risk.



SECURED LOANS AND COLLATERAL

Secured loans are backed by a borrower's property or assets, often called collateral. The most common types of collateral are homes and vehicles. The value of the assets gives the lender security against an unpaid loan, meaning the lender can set a lower rate for the loan.

The borrower's risk of losing his/her property is a good reason to pay back the loan on time. Interest rates on homes and cars often are much lower than loans that are unsecured or are secured by other types of property.

- Your home mortgage is secured by the house; you risk losing your home to foreclosure if you do not make your payments on time.
- Your car loan is secured by the car you are financing; you risk losing your car to repossession if you do not make your payments on time.

Some lenders hold a car or truck title that has no liens, or claims against it, as security against the loan. If you do not make the payment when due, the lender holding the title has the right to repossess the vehicle. This type of loan can increase your risk.

When you secure a loan with collateral, you always risk the loss of this item for breaking the terms of your loan contract.



POST-DATED CHECKS OR ACH PAYMENT

Post-dated checks are paper checks written by the account holder for a date in the future, often your next payday. Some short-term lenders accept post-dated checks to ensure payment of the loan. If payment is not received by the due date, this check may be cashed by the lender on the check's effective date. To make sure this check is not rejected by your bank for lack of funds, which will add fees and penalties, you must have enough money in your checking account by the date on the check.

The Automated Clearing House (ACH) is an electronic payment network in the United States. It allows funds to be electronically withdrawn or credited to an individual's checking or savings account. Instead of a post-dated check, some lenders will arrange to make a pre-authorized electronic withdrawal or debit through the ACH network from a checking account on a specified date. You must have enough money in your checking or savings account by the specified date to avoid fees and penalties.



PAYMENT HISTORY REPORTED TO CREDIT BUREAU(S)

The higher your credit score, the lower your cost of credit. Not every lender reports to the credit bureaus. Your credit score can only improve if your good payment practices are reported to the credit bureaus. Making timely monthly payments is an important factor in raising your credit score and lowering your cost of credit in the future. Building a credit history is important for borrowers who do not have a long credit history, such as young adults and immigrants.

Not every lender reports your payment practices to the bureaus and not every type of loan can be reported. Check with your lender to see if your payment history will be reported and if your loan is eligible.

LENDING OPTIONS

Dealing with real people, sitting face-to-face across a desk, in a building that has been part of your community for many years should give you some confidence and trust in the staff and loans being offered there. Traditional loan products have not changed much for generations, and installment lenders have been operating in the community for more than 100 years .

Online lending has become more popular in the last decade. At the same time, so have Internet scams. Before putting your personal and financial information in an online loan application, make sure that the website and company are legitimate. Do some research on the company. For example, are they a member of the Better Business Bureau or does someone answer the phone number listed on the website? Is an address listed on the website? Search for and read reviews of the company and its website. One way to do this is to search for the words “scam,” “complaint” or “review” along with the company name.

When seeking credit, for whatever reason, you would be well served to find a lender that has a good reputation and recognizes that a borrower who understands the credit risks involved in each loan will be a good customer for life.

QUESTIONS TO CONSIDER:

- Does the lender have a good track record among your family, friends and neighbors?
- Do they focus on customer service, educating you on your options and giving you a full and complete explanation of your loan, your responsibilities and your obligations?

Take the time to shop around when seeking credit, just as with other products, and make sure you understand the possible risk involved, understand the loan terms, and make the decision that is best for you.



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