



# The Basics of Building Credit

This program was developed to help middle school students learn the basics of building credit. At the end of this lesson, you should know about all of the Key Topics below:

## » Key Topics

- **What a credit card is**
- **How credit is measured**
- **How to build good credit**
- **How to avoid bad credit**
- **The difference between bad credit and no credit**
- **How credit cards impact credit scores**
- **When you can start building credit**

Through interactive examples, simple explanations, and a few corny jokes, you will know more about credit than most adults do nowadays. Think you're ready for this? Great! Let's get started.

## » Table of Contents

What is credit?	2
How is credit measured?	4
How can I build good credit?	6
Why do some people have bad credit?	8
Is no credit the same as bad credit?	10
What do credit cards do for credit scores?	12
When can I start building my credit?	14
Glossary	15

# The Basics of Building Credit

## » What is credit?

The dictionary defines **credit** as “confidence in a purchaser’s ability and intention to pay, displayed by entrusting the buyer with goods or services without immediate payment.” But what does that really mean?

Simply put, credit is a measure of how likely you are to pay something back. When you buy a car without paying for all of it at once, your credit tells the bank if you can be trusted with a loan.

**Good Credit = Easy to Trust**

**Bad Credit = Hard to Trust**

Just about every purchase you will make as an adult will involve your credit in some way. You need credit to buy a car, rent a house, get a loan, apply for a **credit card**, and do anything along those lines. The sooner you start building your credit, the better off you will be.

*Think about it...*

Pretend for a second that you are a car salesman, and a customer wants to buy a brand new car on the lot. She does not have the cash for the car, but she says she can afford to make monthly payments for five years. As the dealer, you now have to decide if you can trust this person with your vehicle, or if you will lose money doing this.



How are you going to see that the buyer has the money? Are you going to look at her pay stubs? Her bank statements? Her handwritten promise? Her Facebook profile?

The only way to really know if this is a good idea is to look at her past. Has she made payments on anything else before? Does she owe money to a lot of other people? These answers are all part of her credit.

By looking at the buyer’s credit, you can see if she is “worth” selling the car to.

## Exercise 1

Choose the best answer.

**1.** What does credit measure?

- A: How likely someone is to pay back a loan
- B: How well someone has made payments in the past
- C: How trustworthy someone is with money
- D: All of the above

**2.** When do you need credit?

- A: When you apply for a loan
- B: When you apply for a credit card
- C: When you apply for a house
- D: All of the above

**3.** What does bad credit say about you?

- A: That you are hard to trust with a loan or credit card
- B: That you do not make much money
- C: That you are young
- D: That you watch a lot of bad movies

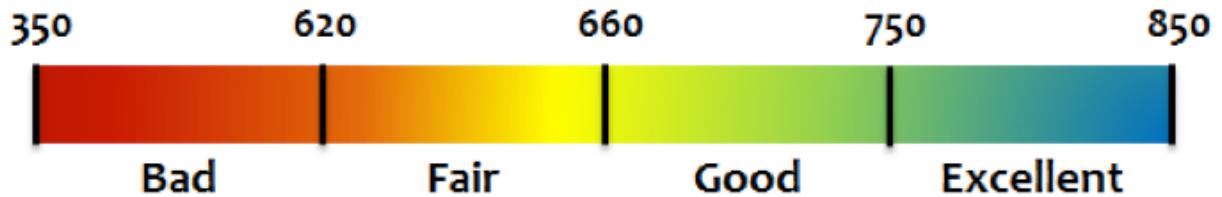
**4.** What does good credit say about you?

- A: That you make a lot of money
- B: That you have many credit cards
- C: That you are easy to trust with a loan or credit card
- D: That you have a lot of Facebook friends

# The Basics of Building Credit

» How is credit measured?

Once you start building it, your credit will be assigned a number, known as your **credit score**. Credit scores range from 350 to 850, with 850 being the best score you can get. Here is a look at how credit scores are ranked:



Your credit score will not start out at 350. Chances are it will start in the 500's or 600's, depending on what you do to build it. Most people fall into the "fair" or "good" credit ranges. The national average credit score is 691.

*It's like school.*

Think of a credit score like a grade you get in class. A 95 is better than an 87, and an 87 is better than a 65. The harder you work, the higher your score is probably going to be. Getting bad grades on multiple assignments will lead to a bad grade for the semester. That's what happens with your credit score.

Every time you make a payment for a loan, credit card, or a bill (in some cases), you get a positive mark on your credit. This mark won't have a specific value like a grade in class would, but it will work with all the other marks to determine how high your score will go. Long, steady **payment histories** improve credit, and missed payments make it worse. You have to keep track of your score to make sure it stays high.

## Exercise 2

Choose the best answer.

1. What would a 622 credit score be considered?
  - A: Bad
  - B: Fair
  - C: Good
  - D: Excellent
2. What would a 425 credit score be considered?
  - A: Bad
  - B: Fair
  - C: Good
  - D: Excellent
3. What range of scores describes people with “good” credit?
  - A: 350 – 619
  - B: 620 – 659
  - C: 660 – 719
  - D: 720 – 850
4. What range of scores describes people with “bad” credit?
  - A: 350 – 619
  - B: 620 – 659
  - C: 660 – 719
  - D: 720 – 850
5. What is the national average credit score?
  - A: 455
  - B: 561
  - C: 691
  - D: 720

# The Basics of Building Credit

## » How can I build good credit?



Building good credit is an important part of being an adult. Even if you never need to get a loan, you can use a good credit score to get discounts on phones, clothing, electronics, and more. There are several ways to build good credit, and one is no better than the others. You could...

- Make payments on a credit card.
- Make payments on a small loan.
- Make payments on a piece of furniture.
- Make payments on a house (not in rent).

You get the idea. Everything revolves around paying someone for something. In order to build credit, you have to find people that will trust you with a small amount of money. If you pay that back on time, you will get a good mark and a higher score.

*It's still like school.*

Let's go back to the idea of getting grades in class. If you turn in your assignments on time with the right information, you will get a good grade. Late or incomplete homework will not have as high of a grade. It works the same with credit. If you don't make a payment on time or you make less of a payment than you need to, your credit score will not be as high. It's as simple as that.

*It takes credit to make credit.*

Before you get excited about all of this, remember that you need credit to make credit. Sadly, most places that will help you build your credit want to see examples of your credit from the past. If you have no score to show them, you might not get the opportunity you need.

When you first try to build your credit score, you will need to get small credit cards and **loans** from companies that don't look at past credit. These credit cards and loans will not be worth much, but they will give you a chance to get started. You may also get credit by paying on your household bills, like your cable, internet, electricity, and water. You will have to have those anyway, so they will help slowly improve your credit score.

You can also work with someone called a **cosigner** if you apply for a loan. This is a person that already has credit and is willing to put his or her name on a loan for you. By cosigning with you, this person is telling the bank that he or she will take over your payments if you stop making them. Your cosigner could be a parent, a grandparent, a friend, or anyone that you know with a steady income and a good credit score.

## Exercise 3

Choose the best answer.

**1.** Which of the following probably has the highest credit score? Assume that all of them have made regular monthly payments on time.

A: An 18 year old college freshman

B: A 20 year old waitress with two active credit cards

C: A 40 year old business owner with two cars, a house, and four active credit cards

D: A 50 year old with five credit cards who rents his house.

**2.** What makes a person a good cosigner?

A: A high credit score

B: A steady income

C: The ability to pay for your loan if you can't

D: All of the above

# The Basics of Building Credit

## » Why do some people have bad credit?

Bad credit comes from not making payments on time. It has nothing to do with how much money you owe in loans and credit cards. You can be in a lot of debt and still have a good credit score if you are making all of your payments on time. Factors that lead to bad credit include:

- Missed payments
- Payments lower than the minimum amount required
- Outstanding debts (Those that you have not paid for a long time)
- Excessive credit inquiries (Too many people looking at your credit)
- Car repossessions (You lost your car because you couldn't pay for it)
- Home foreclosures (You lost your house because you couldn't pay for it)

If you get a loan or a credit card that you don't pay for, you're going to get a bad credit score. Sometimes you can't avoid this, like if you get medical bills in a car accident. Other times, you have to find a way to make your payments on time if you want to keep your credit score high.

*Let's go back to school.*

If we go back to the school comparison, a bad credit score is like someone not turning in any homework assignments for the whole semester. If you miss a big test or fail it because you were not prepared, your grades will go down. The same will happen with your credit score if you cannot make the payments on your loans.



## Exercise 4

Choose the best answer.

**1.** Which person probably has the lowest credit score?

A: A woman who has missed three credit card payments in a row

B: A man who has had three car repossessions

C: A woman who has a \$125,000 house loan

**2.** Which of these people has a bad credit score? Assume they are all making their payments on time.

A: A woman who owes money for a house, car, and loan

B: A man with five credit cards

C: A college freshman with \$15,000 in student loans

D: None of the above.

# The Basics of Building Credit

» Is no credit the same as bad credit?

A lot of people worry when they have no credit at all, assuming it is bad credit. That is not the case at all! Bad credit shows that you had a chance to pay on a loan or credit card and you didn't do that. **No credit** simply says you haven't had a chance to build your credit yet.

When you first become an adult, you will have no credit at all. Nevertheless, some companies will be willing to work with you to help you build your credit. If you miss payments on a regular basis, your credit score will be low. Then those same companies probably will not want to work with you.

*What did we say about school again?*

When you first start school, do you have bad grades? Of course not! You just don't have any grades yet. As you go through the semester, you will work on assignments to hopefully get good grades. If you don't complete your work after that, you will end up with a D or an F.

Credit works the same way. You have to have a chance to prove yourself before you get a bad score. If you haven't started working on your credit, you don't have bad credit just yet.



## Exercise 5

Choose the best answer.

**1.** Which of these people has bad credit?

A: A person who just turned 18

B: A 22 year old who has never missed a payment on anything

C: A 40 year old who has never had a loan or credit card

D: None of the above

**2.** True or false: Bad credit is better than no credit.

A: True

B: False



When used correctly, credit cards can do wonders for credit scores. Every positive payment you make on your credit card will be a good mark on your credit history. Make these payments consistently, and future lenders will see that you can be trusted with a line of credit or a loan.

However, failure to make your credit card payments could lead to disasters on your credit score. Most credit card companies are more likely to report bad credit than they are to report good credit. In other words, it only takes one mistake to make your credit score drop significantly, even if you have a great history before that.

*This isn't like school. It's like life at home.*

Think about how life works at home. If you do your chores for months at a time, your parents will eventually assume that you're going to do your chores. The first time you break curfew, you're grounded for two weeks. It doesn't matter how many times you cleaned your room, put up the dishes, washed the dog, or gave Grandpa Sam his meds. You're going to be in trouble for breaking the rules.

Credit card companies do the same thing. They don't pat you on the back and thank you for making your payments. They put horrible marks on your credit when you don't make your payments. That's why it's so important to make your credit card payments on time.

## Exercise 6

Choose the best answer.

- 1.** What does it take to keep a good credit score with credit cards?
  - A: Making your monthly payments on time
  - B: Making most of your payments most of the time
  - C: Thinking about making your payments but not actually making them
  - D: Never making your credit card payments
- 2.** Will credit cards ever hurt your credit score?
  - A: No, just having them makes your credit score go up
  - B: Yes, because they are considered as debt
  - C: Yes, but only if you miss a payment
  - D: Yes, but only if you have a huge credit card balance

# The Basics of Building Credit

» When can I start building my credit?

Unfortunately, you won't technically be able to build your credit until you turn 18. With this in mind, there are things you can do now to start developing good habits for the future. If you learn how to manage your money and your accounts correctly, you won't have to worry about credit card debt in the future. Here are some ideas to keep in mind:

- **Practice with a prepaid card or debit card.** You can buy one of these if you're 13 or older, as long as you have your parent's permission. With a prepaid card, you put a certain amount of money on the card, and that acts as your spending limit. If you have a bank account, you could also ask your parents to get you a debit card to use. Then you can monitor your spending on the card, pretending there are fees associated with it. Take this seriously, and you'll feel like you own a real credit card!
- **Learn about different forms of credit and the fees associated with them.** Think about this as research for what's to come. Check out some of the different loans and credit cards you might get when you're an adult. You'll soon know what to look for and what to avoid, which will hopefully help you make better decisions in the future.
- **Help your parents monitor their credit.** If your parents will allow you to see their credit reports and scores, take up the opportunity! This may show you more than you need to know about their finances, but at least you'll get to see what credit is really like. If you can't look at your parents' credit, ask them questions about how their credit scores have changed over the years. Find out why they changed the way they did, and make note of any mistakes to watch out for.
- **Live on a budget.** If you're one of those lucky kids that gets anything he or she wants from his or her parents, stop taking advantage of that. Instead, take your allowance and put it away for safe keeping. Put yourself on a budget and actually stick to it. Sure, these are adult problems, not middle school problems. That doesn't mean you can't grow up just a little bit right now.

For the most part, you just have to learn how to spend money responsibly. If you can do that, you will naturally build good credit when you're 18.

Good luck!

**budget:** Making a plan for your money in order to spend wisely.

**cosigner:** A person who puts his or her name on a loan with a person, offering to make payments if that person cannot do so in the future.

**credit:** A measure of how likely a person is to pay back a loan or manage a credit card.

**credit card:** A plastic card that represents an account.

**credit score:** A number that represents how good or bad a person's credit is.

**debit card:** Different from a credit card, but similar to a prepaid credit card. Usually associated with a bank that allows you to pay for things.

**loan:** Something borrowed, like money, which must be paid back.

**no credit:** Someone that has no credit history. Not good or bad credit.

**outstanding debt:** Debt that has not been paid for over 30, 60, or 90 days.

**payment history:** What creditors look at in relation to your credit score to decide if they should loan to you.

**prepaid card:** Different from a credit card and similar to a debit card. Usually issued by a credit card company after a deposit has been placed on it in order to make purchases.