Fact sheet 9

Borrowing

This fact sheet looks at how to access and manage credit. It can be used:

— as a discussion starter with family members and friends.

— for self-reflection to check how much you already know and where to find more information.

Using credit is not always a bad thing, but choosing the right type of credit and being able to skilfully manage it is essential to protect your financial future.

1. Did you know?

— As of 1 September 2017 Australians owed around $32 billion on credit cards where interest is being charged.

— The average card holder is paying around $700 in interest per year on an average balance of over $4,000.

— If you had $4,100 of credit card debt and only made the minimum monthly repayments, it would take you 33 years to pay it off and cost you over $9,500 in interest.

— But if you were to stop using the credit card and increase your monthly payment to $200, you'd pay back the debt in two years, paying just under $800 in interest.

— Credit card debt peaks in the first quarter of each year after Christmas spending.

2. Types of credits

There are many different types of credit that can be used for different purposes. The primary cost of credit is interest, but when you access credit, you can also be charged for:

- set-up fees for setting up a loan or credit
- an annual fee, generally for credit cards but can be charged for other types of credit
- late payment fees, which is an extra cost for when you pay past the due date
- over-the-limit fees for when you access more than the maximum limit you are allowed on your credit card
- processing fees for handling payments and managing accounts.

Examples of credit:

— PERSONAL LOAN (UNSECURED)
This type of credit is typically used for travel, weddings, study, renovations and debt consolidation.

— PERSONAL LOAN (SECURED CAR LOAN)
A lower fixed interest rate is charged as the car is used as security for the loan.

— HOME LOAN (MORTGAGE)
This type of loan is available only for homes (houses and apartments etc.).

— PAYDAY LOAN
Generally incurs an establishment fee and a monthly account-keeping fee.

— INTEREST FREE LOAN
High interest is generally charged if the full amount is not repaid before the end of the interest-free period.

— CREDIT CARD
In addition to interest charged monthly on the unpaid balance, costs can also include the annual fee, as well as fees for rewards programs, late payment and exceeding the credit limit.

— STORE CARD
This type of credit card can only be used in limited places.

— CONSUMER LEASES
You pay rent (and possibly other fees and charges) on an item for a fixed amount of time. Leases generally cost a lot more than buying the item for cash.

— RENT TO BUY (HIRE PURCHASE)
This is similar to a consumer lease, but you own the asset at the end of the rental period.

3. Strategies for using credit wisely

- Select the credit product that is best for you and fits the purpose for which it is required.
- Shop around for the best credit product in terms of interest rates, fees and charges, and special features.
- Generally, the best use of credit is for good debt (appreciating assets) and not bad debt (general expenses and depreciating assets). Know the difference between items which can be purchased for cash, and items which are difficult to purchase without credit.
- You can check that you can meet ongoing repayments before you sign up for credit by using an online calculator and creating a budget.
- Don't be tempted. Because a credit card is so convenient, it's easy to lose track of what you're actually spending.
- Try to repay your credit card in full and on time each month.
- Try to stop temptation by keeping your credit limit to a minimum.
- It can be a good idea to resist the urge to have multiple credit cards.

4. Power words for borrowing

Understanding and being able to use these words will provide you with more power to use credit wisely.

APPRECIATING ASSET	Something you own which grows in value over time.
CASH ADVANCE	Using a credit card to withdraw cash which usually accrues a higher interest rate charge.
COMPARISON RATE	Helps you compare one loan with another by including fees and charges as well as the interest rate.
COMPOUND INTEREST	Where interest charged for credit (such as a loan or credit card purchases) is added to the balance owing, thereby also attracting interest.
CREDIT RATING	A ranking which is based on your credit history and represents your ability to repay a debt.
CREDIT LIMIT	The maximum amount of credit that a lender will extend to a borrower.
CREDITOR	The lender or financial institution that the borrower owes money to.
DEPRECIATING ASSET	Something you own but which loses value over time.
FIXED INTEREST RATE	When the interest rate of a loan remains the same for the term of the loan or an agreed timeframe.
INTEREST	The cost of borrowing money.
PRINCIPAL	The original amount borrowed from the financial institution.
SECURITY	The asset for which you require a loan, which the bank has the authority to repossess, sell and recover the money owing if you were to fail to repay the loan.
VARIABLE INTEREST RATE	When the interest rate of a loan changes with market conditions for the duration of the loan.

ASIC's Money Smart Credit card debt clock

5. Need more help? Want to know more?

- A wide range of information about credit is available on ASIC's MoneySmart website.
- Find out how much Australians currently owe on their credit cards.
- Try a calculator to see how long it will take to repay an outstanding balance on different types of loans.

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