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FACT SHEET

L-756

COST OF CREDIT

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When buying on credit, you pay an extra charge called *interest* or *finance charge*. Although credit lets you use things while paying for them, you may spend more than you can afford.

HOW MUCH CAN YOU AFFORD?

Study your family situation. Are you spending for longtime family happiness and security? Conservative estimates suggest that after home mortgage a family can carry payments of 15 to 20 percent of monthly income after tax deductions. However, families with high housing expenses, several children, large medical expenses or unemployment problems cannot carry even 15 percent.

Figure what you can afford by listing categories of spending and record your expenditures for a period of time. Weigh the amount spent against your income. Is there money left for additional payments? Plan future expenditures based on what you spend now. Allow for unexpected expenses.

Ask yourself these questions when considering the use of credit:

- Is this item worth the added cost?
- Will the item last longer than the payment period?
- Could I save now to pay cash for future items?
- What is the difference between the cash price and the credit price?
- Could I pay less by choosing another form of credit?
- Could I make a larger down payment without upsetting the family spending plan?
- Do I pay off debts as quickly as possible?
- Can I meet this payment plus all other monthly expenses?

CREDIT CHARGES

Texas laws governing charges for credit changed with passage of the Texas Consumer Credit Code. Under the Credit Code, charges vary with the type and amount of credit and the length of payment schedule. Rates may vary from one institution to another but are subject to the same maximum limits.

Interest charges may not exceed 10 percent per annum except where provided for in the Code. However, not all lending institutions charge maximum rates.

TRUTH-IN-LENDING ACT

The Federal Truth-in-Lending Act became effective July 1, 1969. It does not affect the charges for credit that are allowed under the Texas Consumer Credit Code. However, it specifies that lenders and businesses extending credit to borrowers and customers must let them know the cost of credit. Then they can compare credit costs with those of other credit sources and avoid uninformed use of credit.

The finance charge and annual percentage rate are the two most important disclosures required by this Act. They tell a customer, at a glance, how much he is paying for his credit and its relative cost in percentage terms.

The Act first applies to any individual or organization that extends or arranges credit for which a finance charge is payable or which is repayable in more than four installments. For example: banks, savings and loan associations, department stores, credit card issuers, credit unions, automobile dealers, consumer finance companies, residence mortgage brokers and craftsmen such as plumbers and electricians. It also applies to doctors, dentists and other professional people and hospitals.

The Act applies to all credit extended to people for personal, family, household or agricultural uses, not exceeding $25,000. All real estate credit transactions for these purposes are covered regardless of the amount.

The Act divides all consumer credit transactions into two broad categories – open-end credit and credit other than open end.

OPEN-END CREDIT

Open-end credit covers most credit cards and revolving charge accounts in retail stores where finance charges are usually made monthly on unpaid amounts. Commercial banks and some other creditors have very similar plans. They issue a small plastic card that you may use to buy goods and services at various businesses showing the sym-

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bol of the particular plan in their window. This is sometimes called charge-account banking. With these two forms of open-end credit you can always avoid paying any finance charge if you pay each bill promptly. The creditor is required to describe how he determines his finance charge. He must tell you how he determines the unpaid balance in your account and what percentage he uses to compute the finance charge as an annual rate. It is not possible for the creditor to tell you in advance what your dollar finance charge will be. This will depend upon how much you use your open-end account and how rapidly you repay.

The creditor must also send you certain information with each statement. He must show the previous balance owed, if any, additional amounts of credit you used during the month, the amount of any finance charge and the new balance.

You pay more for the use of credit if the finance charge is applied to the *previous balance* rather than to the *adjusted balance*. The adjusted balance is what you owe after making a payment and returning any merchandise. The previous balance is what you owed before you made your last payment and returned any merchandise.

Retail Charge Agreement

The Texas Consumer Credit Code allows a maximum monthly charge on retail charge agreements (revolving credit). It is 1.5 percent on unpaid balances of $500 or less (15 cents per $10 per month) and 1 percent on any unpaid balance over $500 (10 cents per $10 per month).

A minimum finance charge of not more than 75 cents per month may be charged for any billing cycle, and reasonable attorney fees and court costs may be added if the buyer defaults.

The charges for revolving charge accounts vary with how the seller computes the finance charge, even though the law sets maximum charges. The unpaid balance may be considered at the end of the present billing cycle, on the unpaid balance of the previous billing cycle or at the beginning of the cycles. It may be figured on the exact amount owed or on the midpoint in units of 10. Whatever the method, it must be used on all accounts.

Each month (not necessarily a calendar month) the buyer is furnished a statement showing: the unpaid balance at the beginning and end of the month, the dollar amount of each purchase or service, payments or other credits made during the period, the finance charge for the period, the corresponding annual percentage rate, the minimum periodic payment required, and a statement that the buyer can pay any unpaid part or balance at any time.

Be sure you understand the method of applying the finance charge so you can shop for the cheapest form of revolving credit. Some retail charge agreements do not use the minimum charge of 75 cents but use 50 cents as the minimum charge. There are others which do not use either minimum charge. For instance: if a $30 balance is left, the charge is figured on the exact amount which would be 45 cents rather than 50 cents.

CREDIT OTHER THAN OPEN END

Credit other than open end includes both loans and sales credit. This type is used in buying or financing the purchase of "big ticket" items. The Texas Consumer Credit Code includes regulated loans, installment loans and secondary mortgage loans.

Regulated Loans

Regulated loans, a form of credit other than open end, are cash loans up to and including $2,500. The loan period is limited to 37 months for $1,500 or less and to 43 months for more than $1,500.

The following interest rates may be charged:

$ 0 - 300	$18 per hundred per year
$300 - 2,500	$ 8 per hundred per year

The interest on a $400 loan for 12 months, payable in monthly installments, would be $62. It is figured as follows:

$ 0 - 300 at $18 per hundred is 3 × $18 = $54
$100 at $8 per hundred = $8
$8 + $54 = $62 for $400

The dollar cost is $62. The monthly payment is $462 divided by 12 = $38.50. Alternate rates of interest are authorized for use on loans of $100 or less.

Amount Borrowed	Other Charges
Any amount to $29.99	$1 per $5 loaned.
Above $29.99 to $35	Not over 1/10 of the amount loaned, plus a handling charge not over $3 per month.
Above $35 to $70	Not over 1/10 of amount loaned, plus handling charge not over $3.50 per month.
Above $70 to $100	Not over 1/10 of amount loaned, plus handling charge not over $4 per month.

The terms of loans made under these rates may not exceed 1 month for each $10 loaned up to maximum of 6 months.

A $100 loan for 6 months at these rates requires 1/10 of $100 = $10 + $4 per month for 6 months

= \$24. \$10 + \$24 = \$34, the dollar cost for using \$100 for 6 months.

On all loans of \$100 or more, a lender may require a borrower to provide credit life insurance and credit health and accident insurance as additional loan protection. On loans of \$300 or more the lender may require the borrower to insure tangible personal property as security.

Installment Loans

These loans are repayable in consecutive, fairly equal, monthly installments. There is an add-on charge of \$8 per \$100 per annum for the full term of the loan with no limit on the amount loaned or the repayment period.

Credit life and credit health and accident insurance can be required on any installment loan regardless of the amount.

Secondary Mortgage Loans

A bank, savings and loan association or any lender licensed under the Credit Code may offer secondary mortgages at the add-on interest rate of \$8 per \$100 per annum for the full term of the loan with no limit on the loan amount or term. Any other lender is restricted to the maximum 10 percent per annum interest rate. The lender is entitled to charge appraisal and inspection fees not to exceed \$25 per tract of land, a credit investigation fee not to exceed \$12.50, attorney fees for preparing documents not to exceed \$35 and official filing, recording, construction permit fees, plus title insurance or title examination fees. In addition, the lender can require credit life insurance and credit health and accident insurance.

The Truth-In-Lending Act gives the customer the right to cancel a credit arrangement within three business days if his residence is used as collateral for credit. To cancel he must sign and date the notice he received from the creditor and either mail it to the creditor at the address shown on the notice or take it to the creditor or he can send a telegram to the creditor giving a brief description of the transaction he is cancelling. Or he can write a letter giving a description of the transaction he is cancelling and mail it or deliver it to the address.

A first mortgage to finance the purchase of a residence carries no right to cancel. However, a first mortgage for any other purpose and a second mortgage on the same residence may be canceled.

The Truth-In-Lending Act requires that before the loan is made, the creditor must give the customer in writing the following information:

1) The total dollar amount of the finance charge, except in the case of credit for purchase of a house.
2) The date the finance charge will begin, if this is different from the date of the transaction.
3) The annual percentage rate.
4) The number, amounts and due dates of payments.
5) The total payments, except in the case of first mortgages on homes.
6) The amount of charges for any default, delinquency, etc., or the method for computing the amount charged.
7) Description of any security held.
8) Description of any penalty charges for prepayment of principal.
9) How the unearned part of the finance charge is calculated in the case of prepayment. Charges deducted from any rebate or refund must be stated.
10) Amount financed plus all charges must be itemized.
11) Amounts that are deducted as prepaid finance charges and required deposit balances.

Monthly statements are not required, but if they are sent the annual percentage rate and the period in which a payment must be made to avoid the late charges must be stated.

The annual percentage rate is calculated on loans or credit other than open end by the actuarial method. This means that payments are applied first to the interest due and any remainder is then applied to reduce the principal.

Specially prepared tables are used based on the finance charge and the number of weekly or monthly payments to be made.

The annual percentage rate must be shown unless the finance charge is \$5 or less, and applies to credit of \$75 or less. The same exception applies to a finance charge of \$7.50 or less on credit of more than \$75.

The borrower may repay his loan at any time and obtain a refund of a portion of the finance charge.

Retail Installment Sales

Retail installment contracts (included in the Texas Consumer Credit Code) involve the sale of consumer goods or services. Each contract is required to be in writing with all charges and provisions disclosed.

The term *finance charge* means the amount paid or payable for purchasing goods or services on credit. The term *cash price* is the cash price of the good or service. *Deferred payment* price is the total of the cash price and all other charges, including the *finance charge*.

The buyer is cautioned not to sign his name before reading the contract or when there are any blank spaces.

When buying on credit the merchant must give the customer the following information in writing:

1.	Cash Price	$____	
2.	Less: Cash down payment	$____	
3.	Trade-in	____	
4.	Total down payment		$____
5.	Unpaid balance of cash price		$____
6.	Other charges:		$____
	____		____
7.	Amount financed		$____
8.	Finance charge		$____
9.	Total of payments		$____
10.	Deferred payment price (add items 1, 6 and 8)		$____
11.	Annual percentage rate		____%

The annual percentage rate must be shown unless the finance charge is $5 or less, and applies to credit of $75 or less. The same exception applies to a finance charge of $7.50 or less on credit of more than $75.

From the *deferred payment price*, item 10, the number of installments, dates of payment and amounts must be spelled out clearly.

Monthly statements do not have to be made, but if they are sent the annual percentage rate and the period in which a payment must be made to avoid late charges must be stated.

The annual percentage rate on credit other than open end is calculated by the actuarial method. This means payments are applied first to the interest due and any remainder is then applied to reduce the principal.

Specially prepared tables are used based on the finance charge and the number of weekly or monthly payments to be made.

The Texas Credit Code provides maximum legal finance charges based on the size of the principal balance as follows:

Any amount up to $500	– $12 per $100 per annum
From $500 to $1,000	– $10 per $100 per annum
Above $1,000	– $ 8 per $100 per annum

The author acknowledges the cooperation of the Office of the Consumer Credit Commission, Austin.

This amount is figured on the principal balance, item 7, from the date of the contract until the due date of the final installment.

A minimum finance charge can be charged on any retail installment credit and is established on the initial principal balance as follows:

Any amount up to $25	– minimum $ 6
From $25 to $75	– minimum $ 9
Above $75	– minimum $12

These may be charged regardless of the number of installments or the period of credit provided in the contract.

The contract spells out what can be charged for delinquent payments.

The customer has the right to pay the total amount owed at any time and obtain a refund on a portion of the finance charge.

Motor Vehicle Installment Sales

The maximum finance charges in motor vehicle installment sales depend on the "class" into which the vehicle falls. Beginning one month from the contract date, a charge of $25 may be added or an amount determined as follows:

- Class 1. New cars, $7.50 per $100 per annum
- Class 2. New cars of prior models and used cars not over 2 years old, $10 per $100 per annum
- Class 3. Used cars 3 and 4 years old, $12.50 per $100 per annum
- Class 4. Used cars over 4 years old, $15 per $100 per annum; however, a charge of $18 per $100 is allowed if the unpaid principal balance is $300 or less.

The terms of the motor vehicle installment sales contract are basically the same as those of retail installment-sales agreements.

KNOW WHAT YOU CAN DO

If you use credit, know what the cost will be. Know the types of credit available. Compare and shop for the cheapest rate. Remember that costs may vary with the institution, business and your credit rating. Choose the type credit that fits your ability to pay.

Remember:

- Read the contract. Ask questions when you do not understand.
- Put your copy of the contract or agreement in a safe place.
- Make your payments on time.
- Guard your credit rating.
- Avoid perpetual indebtedness.

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