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Self-control key to managing credit card debt in college

By Christine Dugas
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College offers a unique opportunity to experiment. Away from your parents' watchful eyes, you can shave your head, join a rock-climbing expedition or get a tattoo. But if you use credit cards to finance your adventures, you could end up with debts that will linger longer than the Harley-Davidson logo adorning your backside.

Piling up debt during your college years is alarmingly easy. Credit card issuers ply college students with offers of free T-shirts, Internet access and other goodies, just for opening an account. Once you have the cards in your wallet, the temptation to use them is great, says Peter Bielagus, a Boston financial adviser and author of Getting Loaded: A Complete Personal Finance Guide for Students and Young Professionals.

"There's a tremendous tendency to enjoy that time of your life," he says. "I certainly did."

Bielagus, 26, ran up $5,000 in debt on eight credit cards during his early years at the University of Miami. He went out to eat five nights a week, even though his campus job paid just $6 an hour. Vacations and weekend trips pumped up the balance.

Bielagus managed to pay off his debt by the time he graduated. He cut back on spending, worked three jobs, held a yard sale and sold some investments. But many students are unable to retire their credit card balances before they enter the working world.

About 31% of college seniors have balances of $3,000 to $7,000, and 9% have more than $7,000 in credit card debts, according to student lender Nellie Mae (see box).

Good credit

That doesn't mean you should shun credit cards entirely. Potential lenders look at how you've managed credit when determining whether to lend you money.

If you graduate without any credit history, you may have trouble qualifying for a car loan or mortgage, says Jan Davis, president of TrueCredit.com, which provides consumer credit management services.

Temperance is key. Most students need no more than two credit cards, Davis says. Earmark one for routine expenses and pay off the balance every month. Use the other for emergencies, such as a car breakdown or plane ticket home for a family funeral.

Ideally, your emergency credit card should have a low interest rate, because you may have to carry a balance. Carrying a balance can actually enhance your credit rating because it shows lenders you can manage debt responsibly, Davis says. Just make sure you make at least the minimum payment on time every month.

Other credit management tips for college students:

▶ Resist the temptation to apply for a lot of credit cards just to get the freebies. Having a lot of credit cards can hurt your credit record, even if you never use them, Davis says.

▶ Lenders, landlords and other businesses are leery of individuals who have a lot of available credit and a limited income, Davis says. They don't want to be left holding the bag if you use those cards to run up a lot of debts you can't afford to repay.

▶ Watch out for fees. The cool T-shirt you get for signing up isn't really free if the credit card carries a fat annual fee. Some credit cards that offer free air miles or rebates also charge annual fees, so you need to weigh the value of the miles vs. the cost of the card. Research no-fee or low-fee cards at www.cardweb.com.

▶ Check the grace period when comparing credit card deals. Most credit cards give you a 25-day grace period before interest starts accruing on purchases, Davis says. But some cards provide a smaller window, and a few have no grace period at all. As a result, you could end up owing interest even if you pay off your balance every month.

▶ Keep your credit limit low. A low credit limit will help you resist the urge to splurge. But maintaining a low credit limit requires vigilance, Bielagus says. Many card issuers will start you off with a low credit limit, then raise it after a few months, he says.

If you receive a congratulatory letter informing you your credit limit has been increased, call the credit card issuer and decline the offer, he says. If the issuer won't do it, close the account, he says.

▶ After you've used credit cards for a few months, order your credit report. You can get a credit report and credit score from one of the major credit-reporting agencies — TransUnion, Equifax or Experian -- for about $13. Review your credit record carefully for mistakes, such as purchases made by someone with a name similar to yours, Davis says.

Checking your credit report will help you avoid unpleasant surprises later. Landlords, auto lenders and even employers may look at your credit score.

Once you've established credit, you should check your score once a year, Bielagus says.

More college, more credit

Credit card usage increases through college grade levels:

Average number of cards
Freshman: 2.5
Sophomore: 3.67
Junior: 4.5
Senior: 6.13

Pctg. with 4 or more cards
Freshman: 26%
Sophomore: 44%
Junior: 50%
Senior: 66%

Average credit card debt
Freshman: $1,533
Sophomore: $1,825
Junior: $2,705
Senior: $3,262

Pctg. with $3,000-$7,000 balances
Freshman: 8%
Sophomore: 18%
Junior: 24%
Senior: 31%

Pctg. with balances exceeding $7,000
Freshman: 4%
Sophomore: 4%
Junior: 7%
Senior: 9%

Source: Nellie Mae

Self-control key to managing credit card debt in college

Objectives:

Students will:

- read the article, "Self-control key to managing credit card debt in college" for information on credit cards and credit card debt.

- complete a graphic organizer that compares their monthly income to their monthly expenses and other debt.

Concepts:

- Debt
- Income
- Debt-to-income ratio
- Resources
- Responsibility
- Problem solving

Preparation:

- Give each student a copy of the article.

- Divide students into small groups, and have them answer the discussion questions aloud.

- Then, have students complete the graphic organizer "Evaluating your expenses, debt and income" on their own.

Activity at a glance:

- Grade level: 9-12

- Subjects: economics, math, personal finance, social studies

- Estimated time for this activity: 45-50 minutes

Materials:

- Article: "Self-control key to managing credit card debt in college"

- Copy of the discussion questions and activity

- Graphic organizer: "Evaluating your expenses, debt and income"

- Pencil, scratch paper

Self-control key to managing credit card debt while in college

Discussion:

What are the advantages and disadvantages of using credit cards to finance purchases? Why is it easy for college students to pile up debt while in school? What methods do credit card companies employ to persuade students to open accounts? Why is it important to establish some kind of credit history while in college? What is the key to effectively managing credit cards and debt? When is it wise to pay off credit card balances in full? How does carrying a balance help a person? Why is it unwise to have a lot of credit cards, even if you never use them? What information should you research (or read about in a credit card offer) prior to securing each particular card? When and why should you review your credit report?

Activity:

Your credit report is one aspect of your financial resume. Potential lenders review it to examine your borrowing habits and your repayment history. Lenders all use these reports to analyze an individual's debt-to-income ratio. In short, financial institutions use credit reports to evaluate a person's creditworthiness.

Use the attached graphic organizer to assess your credit history and ability to manage your debt responsibly.

Additional resources:

- Goodpayer.com offers a handbook on credit and debt entitled "Learn Now or Pay Later." Visit www.goodpayer.com or to order a copy, call 800-756-4912.

Activity extensions:

- Compare and contrast the interest rates, annual fees and other conditions of two different credit card applications. Decide which offer is better for a student, and explain your reasoning.

- Using a graphic organizer, compare and contrast the similarities and differences between debit and credit cards. Which type of card helps a person establish a credit history? Which is likely to keep a person from becoming overwhelmed by debt? When is it wiser to make purchases using a debit card? When is it in a person's best interest to use a credit card? Explain.

Evaluating your expenses, debt and income

Your debt-to-income ratio (DTI) is a key indicator of your true financial picture. It is the lending industry's measure of fiscal health. Your debt-to-income ratio is calculated by dividing monthly minimum debt payments (excluding mortgage/rent, utilities, food, entertainment, etc.) by monthly gross income. For example, someone with a gross monthly income of $3,000 who is making minimum payments of $600 on debt (loans and credit cards) has a debt-to-income ratio of 20 percent ($600 / $3000 = .20).*

*Source: www.goodpayer.com

With your parents, use the space below to help you calculate your family's debt-to-income ratio as well as your monthly budget. When all of your bills are paid (rent, utilities, etc.), how much is left over to cover mandatory loan payments? After all of your financial obligations are met, how much "pocket cash" do you have to spend?

Monthly expenses (bills, not including loans or other forms of credit)	**Monthly payment**	**Monthly loans (loans or other forms of credit)**	**Monthly payment**
Housing (rent/mortgage)	$___________	Credit card 1	$___________
Utilities (gas, electricity)	$___________	Credit card 2	$___________
Phone/cell phone	$___________	Credit card 3	$___________
Food	$___________	Loan 1 (for example, a car payment)	$___________
Miscellaneous	$___________	Loan 2	$___________
Other	$___________	Loan 3	$___________
Total	$___________	Total	$___________

Monthly income	**Amount**
Work	$___________
Investments	$___________
Other sources	$___________
Total	$___________

Total monthly income	$___________
minus total monthly debt and expenses	– $___________
equals amount left over each month	= $___________
total monthly debt *divided by* total monthy income	$_______ / $_______
equals debt-to-income ratio	= $___________

After completing this exercise, do you have a better understanding and appreciation of what it takes to manage a household?