Unit 4 · Weeks 4-5

Credit & Debt

Borrowing wisely, avoiding traps

LESSON 4.1

What is credit?

LEARNING OBJECTIVES

- Define credit score and explain what factors affect it
- Name the three credit bureaus
- Distinguish hard vs. soft inquiries
- Explain why building credit early is important

READ THIS FIRST

A **credit score** is a three-digit number between 300 and 850 that lenders, landlords, employers, and insurance companies use to predict how likely you are to pay what you owe. A high score (750+) unlocks lower interest rates on loans, better apartment applications, and in some industries, better job offers. A low score (below 580) can mean loan rejections, security deposit requirements of two or three months' rent, or paying thousands more in interest over the life of a car loan or mortgage. Your **credit score** is one of the most financially consequential numbers in your life — and most people don't learn how it works until they've already damaged it.

The most widely used credit scoring model is called **FICO**, developed by the Fair Isaac Corporation. **FICO score**s are calculated from five factors, each weighted differently. **Payment history** is the largest factor at 35%: have you paid your bills on time? One missed payment can drop your score 50–100 points. **Credit utilization** is second at 30%: how much of your available credit are you using? Staying below 30% of your limit is the rule of thumb; below 10% is even better. **Length of credit history** accounts for 15%: older accounts help your score, which is why you shouldn't close your first credit card. **Credit mix** is 10%: having both revolving credit (cards) and installment loans (car, student) helps slightly. **New credit inquiries** is the last 10%: applying for several new credit accounts in a short period signals risk to lenders.

Credit itself — separate from your score — refers to your ability to borrow money with the promise to pay it back later. When you use a credit card, you're borrowing money from the card issuer and promising to repay it, usually within 30 days if you want to avoid interest. When you take a car loan, you're borrowing the purchase price from a bank and repaying it in monthly installments over years. The entity

lending you money is called a **creditor**. Your promise to repay is documented in a credit agreement. **Credit history** is the record of how well you've kept those promises over time.

Your credit history is compiled by three major **credit bureaus**: Equifax, Experian, and TransUnion. These agencies collect data from lenders — your **payment history**, balances, account ages, and any derogatory marks like late payments or collections — and compile it into your **credit report**. Your FICO score is calculated from that report. Because each bureau collects data independently, your scores at the three bureaus can differ slightly. You're entitled to one free credit report from each bureau annually at AnnualCreditReport.com — and reviewing yours is the first step to understanding and improving your financial standing.

Negative items on your credit report don't last forever. A late payment typically stays on your report for seven years. A bankruptcy can stay for up to ten years. But positive behavior — consistent on-time payments, low utilization — builds your score steadily over time and eventually outweighs past mistakes. Credit is not a permanent judgment. It's a living record that reflects your current behavior as much as your history.

Debit cards are worth understanding in contrast to credit cards. When you use a debit card, you're spending money already in your bank account. There's no borrowing, no interest, and no credit being built. Debit cards are fine for day-to-day spending, but they don't contribute to your credit history at all — so relying only on debit means arriving at age 22 with no credit history, which creates its own problems when you try to rent an apartment or finance a car.

> **Why this matters right now:** *Many teens assume credit is something you deal with "when you're older." But credit history length is one of the five FICO factors — the older your accounts, the better. Starting to build credit responsibly at 16–18, even with a single secured card or as an* **authorized user** *on a parent's account, means you arrive at college or your first job with a head start that takes years to replicate later.*

KEY VOCABULARY

Term	Definition
Credit score	A three-digit number (300–850) that summarizes your creditworthiness based on your borrowing and repayment history
Credit report	The full detailed record of your credit history — every account, payment, and inquiry — used to calculate your score
FICO score	The most widely used credit scoring model, calculated from five weighted factors totaling 100%
Credit utilization	The percentage of your available credit you are currently using — keep below 30% to protect your score
Hard inquiry	A credit check triggered when you apply for new credit — temporarily lowers your score by 5–10 points
Soft inquiry	A credit check that does NOT affect your score — includes checking your own credit and pre-approval checks
Payment history	The largest FICO factor (35%) — whether you pay every bill on time, every month, without exception
Authorized user	Someone added to another person's credit card account who benefits from that card's history without being responsible for the debt

LESSON 4.2

How interest works

LEARNING OBJECTIVES

- Calculate simple interest on a loan
- Show how compound interest accelerates debt growth
- Demonstrate the true cost of minimum-only payments
- Compare different repayment strategies

READ THIS FIRST

Interest is the cost of borrowing money. When you carry a **balance** on a credit card or take out a loan, the lender charges you a percentage of what you owe — that's interest. Expressed as an annual rate, this is your **APR (Annual Percentage Rate)**. A credit card at 22% APR is charging you 22% of your outstanding balance every year, calculated and added daily. Understanding exactly how this math works is one of the most financially protective things you can learn, because **compound interest** works powerfully in your favor when you're saving — and devastatingly against you when you're borrowing.

Here's the math on a credit card balance. You have a $1,000 balance at 22% **APR**. Daily, the card charges 22% ÷ 365 = 0.0603% interest. On day one, that's $0.60. On day two, if you didn't pay anything, interest is charged on $1,000.60. This is **compound interest** — interest charged on top of interest previously charged. Over a month, that $1,000 balance generates about $18.33 in interest. Your **minimum payment** is typically 1–2% of your balance, or about $20–$25. At the **minimum payment**, you're barely covering the interest — the principal barely decreases. At $20/month on a $1,000 balance at 22% APR, it takes over 8 years to pay off and costs more than $2,000 total. You pay back more than double what you borrowed.

The difference between the **minimum payment** and paying in full is enormous. If you pay your full balance every month — before the due date — you pay zero interest. Credit card issuers charge interest on balances that carry over from month to month. Pay in full every month, and the card's APR is irrelevant — you're essentially getting a 30-day interest-free loan every billing cycle plus any rewards. This is how credit cards are supposed to work. The interest is there for people who don't pay in full, which is how card companies profit.

Simple interest vs. **compound interest**: simple interest is calculated only on the original principal. Compound interest is calculated on the principal plus all previously accumulated interest. For borrowers, compound interest is the danger — it grows debt faster. For savers and investors, compound interest is the engine — it grows wealth faster. The same mathematical force that makes credit card debt spiral is

what makes a Roth IRA grow dramatically over decades. Direction matters: compound interest working for you is a superpower. Working against you, it's a trap.

Not all **interest rate**s are created equal. A **subsidized federal student loan** might carry 5–7% APR. A car loan from a bank might be 6–10%. A credit card is typically 18–29%. A payday loan can be 300–400% APR (annual). The higher the rate, the more aggressively you should pay down that debt — and the more cautious you should be about incurring it in the first place. When comparing any two borrowing options, the APR is the most important single number to compare, as long as the loan terms are similar.

Amortization is the process of paying off a loan in equal installments over time. On an amortized loan — like a car loan or mortgage — each payment is the same dollar amount, but the split between interest and principal changes over the life of the loan. Early payments are mostly interest. Later payments are mostly principal. This is why paying extra toward principal early in a loan saves dramatically more interest than paying extra late in the loan. If your car loan is $400/month and you pay $450, that extra $50 goes directly to principal, shortening the loan and reducing total interest paid.

Run the numbers: *Use a free online credit card payoff calculator (search "credit card payoff calculator"). Enter a $1,000 balance at 22% APR. Compare three scenarios: minimum payment only, $50/month, and $100/month. Look at the total interest paid and the payoff timeline in each case. The difference between minimum payment and $100/month is usually several years and hundreds of dollars. That comparison, done once, tends to stick.*

KEY VOCABULARY

Term	Definition
APR	Annual Percentage Rate — the yearly cost of borrowing expressed as a percentage, applied daily on credit card balances
Minimum payment	The smallest amount a lender requires you to pay each month — designed to maximize interest collected, not to help you get out of debt
Compound interest	Interest calculated on both the original balance AND previously accumulated interest — accelerates debt growth over time
Avalanche method	Debt payoff strategy targeting the highest interest rate debt first — mathematically optimal, saves the most money
Snowball method	Debt payoff strategy targeting the smallest balance first — psychologically motivating through early wins
Credit utilization	The percentage of your available credit limit you are currently using — impacts 30% of your credit score
Balance	The total amount you currently owe on a credit account, including purchases and any accumulated interest
Interest rate	The percentage charged on borrowed money — higher rates mean more of every payment goes to interest rather than reducing your balance

LESSON 4.3

Credit card traps

LEARNING OBJECTIVES

- Identify at least four common credit card traps
- Evaluate whether a rewards card is worth it
- Explain how deferred interest differs from 0% interest
- Recognize psychological spending triggers

READ THIS FIRST

Credit cards are among the most powerful financial tools available to consumers — and among the most reliably misused. Used correctly, a credit card builds your credit score, earns rewards on spending you'd do anyway, and provides fraud protection that debit cards can't match. Used incorrectly, a credit card can generate years of high-interest debt from a single semester of overspending. The difference between those two outcomes isn't income — it's knowledge and discipline. This lesson covers the specific traps that catch most people, so you can use credit cards as tools rather than being used by them.

The **minimum payment trap** is the most expensive mistake in consumer finance. Credit card companies are legally required to show you on your statement how long it will take to pay off your balance making only minimum payments — and the number is always shocking. A $2,000 balance at 22% APR with a 2% minimum payment takes over 10 years to pay off and costs more than $4,000 total. The minimum payment isn't designed to help you pay off debt — it's designed to keep you in debt as long as possible, generating interest for the card company. Always pay more than the minimum. Ideally, pay the full balance every month.

Deferred interest is a trap hidden in "0% financing" offers — especially common at furniture stores, electronics retailers, and dental offices. The offer says "no interest for 18 months." What it often means is that interest is accumulating at the full rate (often 26–29%) but is deferred — not charged unless you still have a balance when the promotional period ends. If you pay off the full balance before the deadline, you pay zero interest. If even $1 remains, all the deferred interest from the entire promotional period is added to your balance at once. Read the fine print carefully: "0% APR" means no interest accrues. "Deferred interest" means interest accrues but isn't charged yet.

Balance transfer traps can turn a smart debt-reduction move into a bigger problem. Balance transfers let you move high-interest debt to a new card with a lower promotional rate, often 0% for 12–21 months. The trap: most balance transfers charge a fee of 3–5% of the transferred amount upfront. And if you don't

pay off the balance before the promotional period ends, the rate jumps to the card's standard APR, often 20%+. Balance transfers are a legitimate tool for getting out of debt faster — but only if you make a clear payoff plan and stick to it.

Retail store cards seem like a good deal at the register ("Save 20% today!") but consistently carry the highest interest rates in the credit card market — often 28–30% APR. They also tend to have low **credit limit**s, which can hurt your utilization ratio. The 20% one-time discount is rarely worth years of high-interest exposure if you carry a balance. If you want to use a retail card, pay it in full every month and treat the discount as a bonus, not a reason to buy things you otherwise wouldn't.

Cash advances are one of the most expensive things you can do with a credit card. Unlike purchases (which have a **grace period** before interest accrues), cash advances start accruing interest immediately — often at a higher rate than purchases, typically 25–30% APR. They also carry an upfront fee of 3–5%. There is almost no situation where a credit card cash advance is the right financial move. If you need cash urgently, a personal loan, a credit union, or borrowing from family are all less expensive options.

The psychological dimension of credit card spending is real and well-documented. Studies consistently show that people spend 12–18% more when paying with a card versus cash. The physical act of handing over cash creates a moment of awareness — spending feels like loss. Tapping a card or clicking "buy now" doesn't trigger the same response. This isn't a character flaw; it's how human brains process abstraction. The countermeasure is tracking: if every card transaction is reviewed weekly and compared against your budget, the psychological distance collapses. You see the numbers.

> **The golden rule of credit cards:** *Treat your credit card exactly like a debit card — never charge more than you have in your checking account, and pay the full balance on or before the due date every month. Follow this rule and you get all the benefits of credit cards (rewards, fraud protection, credit building) with none of the costs (interest, debt spirals). Break this rule consistently and the card company wins every time.*

KEY VOCABULARY

Term	Definition
Deferred interest	A financing trap where all interest from the promotional period is charged at once if the balance isn't paid in full by the deadline
Balance transfer	Moving debt from one credit card to another, often to take advantage of a lower promotional interest rate
Rewards card	A credit card that offers cash back, points, or miles — only beneficial if you pay the full balance every month
Autopay	An automatic payment set up to pay your credit card bill on a set date each month — ideally set to the full **statement balance**
Credit limit	The maximum amount you are allowed to charge on a credit card — determined by the lender based on your creditworthiness
Statement balance	The total amount owed on your credit card at the end of a billing cycle — paying this in full avoids all interest charges
Grace period	The window between your statement closing date and your payment due date — pay in full during this window and pay zero interest
Cash advance	Taking cash from your credit card — starts accruing interest immediately at a higher rate, with no grace period

LESSON 4.4

Student loans

LEARNING OBJECTIVES

- Distinguish federal from private student loans
- Explain interest capitalization
- Describe income-driven repayment options
- Calculate total loan cost including interest

READ THIS FIRST

Student loans are the single largest financial decision most people make before age 22 — and they typically make it with almost no financial education. The result: over $1.7 trillion in outstanding student loan debt in the United States, with the average borrower owing over $37,000 at graduation. This lesson won't tell you whether college is worth it. That depends on your specific path, goals, and finances. What it will tell you is exactly how student loans work — so that if you borrow, you do it with your eyes open.

There are two fundamentally different types of student loans: **federal** and **private**. **Federal student loans** come from the U.S. government and come with significant protections: fixed interest rates, **income-driven repayment** options (where your monthly payment is tied to your income), deferment and **forbearance** options if you can't pay, and eligibility for loan forgiveness programs like Public Service Loan Forgiveness. You apply for federal aid through the **FAFSA** (Free Application for Federal Student Aid), and your eligibility is based on financial need, not credit history. Federal loans should always be exhausted before considering private loans.

Private student loans come from banks, credit unions, and private lenders. They typically have variable interest rates, fewer repayment options, no income-driven plans, and no forgiveness programs. They require a credit check and often a cosigner for students without established credit. Interest rates can be higher than federal loans — and because they're variable, they can increase over the life of the loan. Private loans are a last resort, not a first option.

Interest capitalization is the feature of student loans that surprises borrowers most. With **unsubsidized** federal loans, interest begins accruing the moment the loan is disbursed — including while you're in school, during your 6-month grace period after graduation, and during any deferment. If you don't pay that interest as it accumulates, it **capitalizes** — meaning it gets added to your principal balance, and then future interest is charged on the larger amount. A $5,000 un**subsidized loan** at 6.5% accrues about $325 in interest per year. Over a 4-year degree, that's roughly $1,300 added to your balance

before you make a single payment — and then you pay interest on $6,300, not $5,000. **Subsidized** federal loans avoid this: the government pays the interest while you're in school, so the balance doesn't grow.

The most important rule in student loan borrowing is called the **one-to-one rule**: your total student loan debt at graduation should not exceed your expected first-year salary in your chosen field. If you want to be a teacher earning $42,000, borrowing more than $42,000 total creates a serious strain. If you want to be an engineer earning $75,000, $60,000 in loans is manageable. This rule isn't perfect, but it's a concrete check against over borrowing. Research salary data for your intended career at sites like the Bureau of Labor Statistics (bls.gov) before deciding how much to borrow.

Loan forgiveness programs exist but come with significant requirements and risks. Public Service Loan Forgiveness (PSLF) forgives remaining federal loan balances after 10 years of qualifying payments while working for a government or nonprofit employer. Income-Driven Repayment (IDR) forgiveness forgives remaining balances after 20–25 years of qualifying payments. Both programs have had implementation problems and changing rules. Don't borrow more than you can repay on your own income and count loan forgiveness as a bonus if it materializes — not a plan.

Before you borrow: *Use the* **federal student loan** *simulator at studentaid.gov to model your exact borrowing scenario. Enter your expected loan amount, your anticipated salary in your field, and your repayment plan. See what your monthly payment will be and what percentage of your take-home income it consumes. A payment that's 10% of take-home is manageable. One that's 25% is crippling. Know the number before you sign — not after your first bill arrives six months after graduation.*

KEY VOCABULARY

Term	Definition
Federal student loan	A government-issued loan for education with fixed rates, income-driven repayment options, and forgiveness eligibility
Private student loan	A loan from a bank or private lender for education — no income-driven repayment, no forgiveness, fewer protections
Subsidized loan	A federal loan where the government pays the interest while you're in school at least half-time
Unsubsidized loan	A federal loan that accrues interest from disbursement — interest capitalizes and adds to your principal balance
Interest capitalization	When unpaid interest is added to your loan principal, so you then pay interest on the interest
FAFSA	Free Application for Federal Student Aid — the form required to access federal loans, grants, and work-study programs
Income-driven repayment	A federal repayment plan that caps your monthly payment as a percentage of your income
1x salary rule	The guideline that total student loan borrowing should not exceed your expected first-year salary after graduation

LESSON 4.5

Building credit safely

LEARNING OBJECTIVES

- Describe at least three ways to build credit
- Explain pros and cons of authorized user status
- Set up a safe first credit card usage plan
- Understand how to monitor credit and protect against fraud

READ THIS FIRST

Building credit takes time — but it doesn't take as long as most people think, and you can start before you're 18. The credit system rewards consistency and patience. The goal at your age isn't to have a perfect score immediately. The goal is to have a **solid, established credit history** by the time you need it — when you apply for your first apartment, your first car loan, or your first serious credit card with real rewards. People who start at 16–17 arrive at 22 with a 5+ year credit history. People who ignore credit until they need it scramble to build from scratch at exactly the moment they can least afford mistakes.

The fastest legitimate way to start building credit before 18 is to become an **authorized user** on a parent or guardian's credit card. As an authorized user, you get a card in your name linked to their account. Their payment history on that card — every **on-time payment** going back years — appears on your credit report. You don't need to use the card at all for this to work. The account age and payment history benefit you immediately. This is legal, common, and one of the most powerful early credit-building moves available. The risk: if the primary cardholder misses payments or maxes out the card, that negative history shows up on your report too. Choose whose account you're added to carefully.

At 18, the most recommended starting point is a **secured credit card**. A **secured card** works like a regular credit card except you make a deposit — typically $200–$500 — that becomes your credit limit. You use the card for small, regular purchases (a streaming subscription, gas, one grocery run per month), pay the full balance every single month, and after 12–18 months of perfect payment history, most issuers upgrade you to an unsecured card and return your deposit. The key is treating a secured card exactly like cash: never charge more than you have in your bank account, and set up autopay for the full balance so you never accidentally miss a payment.

A **credit-builder loan** is another option offered by many credit unions and community banks. Instead of receiving money upfront, you make monthly payments into a locked savings account. The lender reports your payments to the credit bureaus each month. At the end of the loan term (typically 12–24

months), you receive the accumulated funds. You build payment history while building savings simultaneously. It's a particularly good option for people who don't trust themselves with a credit card yet.

Once you have a credit account, protecting it comes down to four non-negotiable rules. **Pay on time, every time** — payment history is 35% of your FICO score, and a single 30-day late payment can drop your score 50–100 points and stays on your report for seven years. **Keep utilization below 30%** — if your credit limit is $500, keep your balance below $150 at any point when the card reports to the bureaus (typically your statement closing date). Below 10% is even better. **Don't open too many accounts at once** — each new credit application creates a **hard inquiry** that temporarily lowers your score, and multiple inquiries in a short period signals risk. **Don't close your oldest accounts** — credit history length is 15% of your score, and closing old accounts shortens your average account age.

Common credit mistakes that take years to recover from: missing a payment and letting it go 30 days late, maxing out a credit card, co-signing a loan for someone who doesn't pay, and letting an account go to collections. If you make a mistake, the most important thing is to stop the damage immediately — pay what you can, contact the lender, and get back to on-time payments. Time plus consistent positive behavior is the only real repair tool. Credit repair companies that promise to fix your credit quickly for a fee are almost universally scams.

Your credit-building roadmap: *Before 18 — ask a parent to add you as an authorized user on a card they pay in full monthly. At 18 — open a secured credit card, use it for one small recurring charge, set up autopay for the full balance, and don't touch the limit. At 19–20 — with 12–18 months of history, upgrade to an unsecured card with modest rewards. Never miss a payment. Keep utilization low. By 21, you'll have a credit score most 30-year-olds would envy.*

KEY VOCABULARY

Term	Definition
Secured credit card	A credit card backed by a cash deposit that becomes your credit limit — reports to bureaus like a regular card, ideal for building credit from zero
Authorized user	Being added to someone else's credit card account — you inherit the account's history without being liable for the debt
Credit-builder loan	A small loan where payments go into a savings account — you get the money at the end, and every on-time payment builds your credit history
Credit ladder	The recommended sequence for building credit: authorized user → secured card → student card → **rewards card**
On-time payment	Paying at least the minimum by the due date every month — the single most impactful credit habit, worth 35% of your FICO score
Utilization rate	The percentage of your available credit you are using — keep below 30% to avoid hurting your score
Credit mix	Having different types of credit accounts (cards, loans, etc.) — worth 10% of your FICO score
Credit age	The average age of all your credit accounts — older is better, which is why you should avoid closing old accounts