We've looked at credit reports and credit scores, but that is not the only thing lenders consider when deciding whether to extend credit to you.

The 5 C's of Credit

1. Character

-person factors that indicate one's stability, reliability, and responsibility.

-ex: how long they've lived at same address, if married, how long they've had their current job

2. Capacity

-one's ability to repay a loan based on their income, debt, payments and cash flow

-debt-to-income ratio (amount of debt compared to income)

-debt-to-service ratios (will learn about on next slide)

3. Capital

-an individual's financial wealth.

-the amount of money one has to invest.

-net worth

4. Collateral

-the assets used to guarantee or secure a loan

5. Conditions

-a lender's desire to finance the borrower is influenced by the terms of the loan such as interest rate, length of loan, etc.

Total Debt Service Ratio (TDS)

A TDS ratio below 40% is what is usually needed to obtain a mortgage.

How do we calculate the TDS?

Add up mortgage payment, property tax, heating costs, other home costs (water, electrical), and all other debt payments (credit card, car loans, etc.) and divide by your gross family income.

Example:
Let's say that each month your mortgage payment is $1600, property taxes are $200, your heating bill is $75, your other utilities are $125, your car loan is $400, and you have a credit card payment of $200.
Your monthly earnings are $7000.00.

To calculate your TDS, add up all debts and divide by monthly salary.

(1600+200+75+125+400+200) / 7000

=$2600/7000

=37.14%

Because your TDS is less than 40% you would be considered for a mortgage loan.

Although the 5 C's show us there are many factors lenders consider before extending credit, managing debt is very important in all of them.

Using debt responsibly is an important skill to learn and manage.

It is also important to know, that most financial institutions include a cause in their agreements that includes **the right of offset**. This means they can take money out of your accounts to pay off outstanding debt you owe. The financial institution can remove these funds from your account without first letting you know, as it is in the agreement. To avoid this, it is important to learn to use and handle debt responsibly.

The 20/10 Rule

The 20/10 Rule is a rule for debt management stating your debt should not be more than 20% of your annual net income and your monthly payments on debt should not be more than 10% of monthly net income. *This does not include mortgage payments.

For example, if you make $60,000 net income per year, your debts should no more than $12 000 per year and monthly debt payments should be less than $500/month.

Good Debt vs. Bad Debt

Is there such a thing as good debt?

Good Debt vs. Bad Debt

Is there such a thing as good debt?

Some may argue that no debt is good debt, however sometimes debt is necessary and could bring value to the borrower.

Good Debt: debt that will ultimately increase your net worth

ex: mortgage, education (could have a higher earning potential)

Bad Debt: debt incurred to purchase items that don't increase in value over time

ex: cars, clothes, restaurant meals, vacations

The above definitions are general. Not all debt can be easily classified as good or bad, they depend on your financial situation! If you have the means to pay it off and receive rewards for using your credit card then all purchases could be considered good debt.

Debt to Income Ratio

A debt-to-income ratio is the ratio of your debt to your disposable income.

Debt/Disposable Income * 100

A debt-to-income ratio of 50% is considered high because this means households are spending more than half of their income on debt repayment. A ratio over 100% means more than their entire disposable income is spent on debt, over 200% means double their disposable income is spent on debt.

In Canada in 2019, the debt-to-income ratio was 181%. This means for every $181 dollars a household has in debt, it has $100 dollars in disposable income.

In 1980, the ratio was only 66% but the interest rates were much higher so debt was more costly.

Let's compare to other countries:

Russia: 34%

Columbia: 47%

Brazil: 52%

Italy: 88%

Germany: 95%

US: 104%

Japan: 107%

France: 121%

United Kingdom: 142%

Korea: 184%

Australia: 217%

Denmark: 282%

There are many strategies to help you deal with debt.

Some examples are **Credit Counseling, Consolidation Loans** (combining all loans into one to be paid over a longer period of time, easier to manage but will lower your credit score), **Collection Agency** (hired to pay the funds past due to the creditor but assigns the worst credit rating, 9, and will significantly affect credit score), and **bankruptcy** (relieves individual of most debts but loses their assets.)

If you have multiple debts to pay off, which one do you think you should pay off first?

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Both methods below involve paying the minimum payment for each account and then putting any money left over toward one account.

High Rate Method:
-put payments toward the account with the highest interest rate because it is the most expensive and adds up faster over time.

Snowball Method:
-put payments toward the smallest account so that you can pay it off completely and have less accounts to pay off.

Debt management is important for many reasons, including those we've discussed such as debt affecting your credit score which affects future purchases and loans. However debt management is important for many more reasons.

Debt affects people in different ways. Some are very concerned with small amounts of debt, while others are not concerned until a much higher amount is reached.

Some who are struggling with debt may often struggle with mental health and well-being because of it.

For example, debt can cause feelings of embarrassment and not wanting to talk to others. Debt can cause emotional stress and blame which could affect relationships. The struggles of debt and the emotions/situations that may result from it could cause depression, anxiety, and many other mental health and well-being struggles. There are also unfortunate links between debt and suicide.

According to a survey by SunTrust Bank, finances are the leading cause of stress in a relationship. 35 percent of all respondents experiencing relationship stress said money was the primary cause of friction.

https://www.cnbc.com/2015/02/04/money-is-the-leading-cause-of-stress-in-relationships.html

According to a poll done in the United States, 1 in 5 Americans in a relationship have spent over $500 dollars without telling their partner, and 6% have secret accounts or credit cards.

Seeking help is very important regarding these emotions, and debt management is no different. Credit counselors are experienced in debt-related struggles and emotions to give the best help possible for your situation.