Is your income certain for the length of time that payments will run? And do you have enough life insurance protection to cover the debt?

2. How do I shop for the best credit "buy"?

Main sources of consumer credit are:

Credit Unions
Small Loan Companies
Personal Loan Department of Banks
Sales Finance Companies
Retail Sales Establishments

The charges from these different sources vary a great deal. Take time to investigate. Find out what kind of service you can expect, what the cost and repayment terms will be. Do this before you decide where to use your credit.

Find out the dollar cost

You probably compare prices on shoes, dresses, coats, housewares. Why not on the cost of credit?

There is no reason why you should feel embarrassed about asking for this information any more than you would hesitate to ask the price of merchandise you might be looking at in a store.

Credit costs vary widely among different lenders and among stores that sell "on the installment plan." In fact, costs may differ considerably among the various "plans" available from a single store.

It will pay to take time to get the facts. Often the down payment and monthly (or weekly) payments are the only figures stated. You need to know more.

Add up the total amount that you will pay on the loan (or credit purchase). Then subtract the amount of money you will receive from the lender (or the cash purchase price of goods you buy in a store). The difference is the *dollar cost* of credit.

It isn't always easy to get a statement of the dollar cost of credit, but you can figure it out for yourself (at least roughly) if you know:

a) the rate of interest (and whether stated on an annual or monthly basis. One per cent per month equals an annual rate of 12%.);

b) the length of time to repay;

c) and whether charges on installment credit are figured on unpaid balance or on the original principal (as in "add on" or "discount" terms).

Look at all three of the above in judging credit terms offered to you.

For example, take a $500 loan or credit purchase to be repaid in one year on a monthly installment plan. If the rates charged are:

1% per month on unpaid balance, the dollar cost will be about $32.00;
6% annual interest on unpaid balance, the dollar cost will be about $16.00;
6% annual interest, "add-on," the dollar cost will be about $30.00.

If the payments were to be spread over 18 months, each payment would be smaller, but the total dollar cost would of course be higher. For example, at the first-listed rate (1% per month on unpaid balance), the cost would be about $47.00. (Compare to $32.00 for 12 months.)

In order to compare costs, you need to get the facts with respect to terms offered to you in any given situation, and sometimes you have to dig for the facts.

Find out the "true" interest rate

It is to your advantage to know the "true" annual rate of interest as well as the dollar cost of using credit.

When you know the cost and terms, you can use this simple formula to compute the true annual interest rate for a particular loan:

$$r = \frac{2\,m\,D}{P\,(n+1)}$$

In this formula.

r=annual rate of interest.

m = number of payment periods in 1 year (12 if you repay monthly, regardless of the number of months your contract is set up to run).

D = total charge (dollar cost).

P = principal of cash advance (purchase price, or cash you receive in the case of a loan).

n = number of payments your contract actually calls for.