



Charting Your Course to Home Ownership

Credit Management

What is Credit?

Credit means someone is willing to loan you money – called principal – in exchange for your promise to pay it back. Good credit means that you make your loan payments on time and you repay your debts as promised. Good credit is important because it makes it more likely that you can get a loan in the future when you want to make a major purchase such as a house.

Three C's of Credit Worthiness

Creditors look for consumers who are stable and have the ability to repay the loans they make. Creditors judge credit worthiness by considering three basic factors: character, capacity and collateral.

Character is judged by reviewing your credit history. Creditors look to see if you pay your current bills on time and if you appear to be willing to repay all of your obligations. They also notice how long you have lived in one place because it can be an indication of stability. Creditors want to know they will be able to find you when it is time to collect!

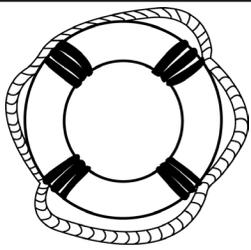
Capacity is your ability to pay. Creditors look to see if you have a stable job and how long you have worked. They will also verify your income to determine if you will be able to meet your debt obligation on your salary. Another consideration is ... how much do you already owe?

Collateral is the assets which you own that can be used to back your loan. Assets, which can be used as security for a loan, include a savings account, a car, a home or other possessions.

Another **C** – **Capital**, may also be considered when applying for a mortgage. Capital indicates whether you have enough money to make a down payment and to close the mortgage.

Credit Reports and Credit Scoring

In today's world, most loans are "score driven." This means a creditor makes a decision about whether to give you a loan and the interest rate they will charge based on your credit score. The biggest advantage to credit scoring is that it avoids discrimination. It's all based on a number – your credit score. Although this number is not part of your credit report, the number is generated by data used in your credit report.



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When you apply for a loan, you authorize your lender to ask for a copy of your credit report. This is an “inquiry.” Your credit report includes both “voluntary” inquiries (those initiated by your own requests for credit) and “involuntary” inquiries (those made for promotional purposes; example: when lenders order your credit report for the purpose of sending you preapproved credit offers in the mail.) Only voluntary inquiries affect your credit score.

What Is a Credit Report?

A **credit report** is a record of your history of credit card debt and other loan repayment. It shows how much debt you have and if you pay on or before the due date. Credit reports are compiled by three national credit-reporting agencies, often referred to as credit bureaus. These credit bureaus are Equifax, Experian and TransUnion. The typical credit report includes four types of information:

- Personal Identification Information:
 - Name
 - Social Security number
 - Date of birth
 - Present and former address
 - Present and former employer
- Trade Lines or Payment Records:
 - Type of account (bankcard, mortgage, installment, revolving, auto loan, etc.)
 - Account number
 - Date account opened
 - Credit limit and/or loan amount
 - Account balance
 - Payment history
- Public Record and Collection Items:
 - Bankruptcies
 - Foreclosures
 - Law suits
 - Wage attachments
 - Liens
 - Judgments
- Inquiries: a list of creditors who have requested your credit history within the last two years

Always remember – a credit bureau is simply an agency that collects and sells payment history about you. They do NOT make lending decisions – **lenders do**. How do lenders make these decisions? They look at your credit score!

What is a Credit Score?

A **credit score** is a number lenders use to help them decide whether to offer you credit, and at what terms, such as interest rate and loan size. This number – your credit score – predicts how likely you are to repay the debt and is based on a statistical model developed by the Fair Isaac Corporation. This score – also known as a FICO® score – is the most commonly used credit scoring system in the United States. Scores range from 300-850 but most people score in the 600s and 700s. Of course, the higher your score, the better!

Lenders generally prefer FICO® scores above 700, because they are considered good and a sign of good financial health. FICO® scores below 600 indicate high risk to lenders and could lead lenders to deny you credit or charge you higher interest rates.

What's NOT in Your Credit Score?

Before determining how to improve your credit score, it's helpful to know what's NOT included in your credit score. Credit scores do not consider:

- Race, ethnicity, religion, national origin, gender, marital status, whether you receive public assistance or have exercised any consumer right under the Consumer Credit Protection Act, such as wage garnishment
- Age
- Salary, occupation, title, employer, date of employment or employment history

Note that lenders may still consider this information as they make the decision about whether or not to give you credit, but this information is not calculated in your credit score

- Where you live
- Interest rate charged on any credit card or other account
- Items reported as child/family support obligations or rental agreements
- Involuntary inquiries (those initiated by creditors for promotional purposes) do not count
- Information not found in your credit report
- Information that is not proven to be predictive of future credit performance
- Participation in a credit counseling program

What IS In Your Credit Score?

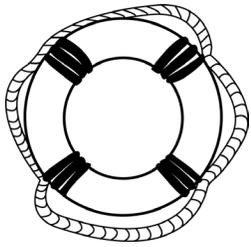
FICO® scores are calculated from a variety of credit data in your credit report. Scores are assessed as follows:

Your payment history = 35% of your credit score.

- Pay your bills on time – Late payments or delinquent items lower your credit score. The severity of the delinquency (how long a bill is past due) is also an important factor. A good track record of paying your bills on time will increase your credit score.
- Bankruptcies, collections and adverse public records (example: foreclosures, law suits, wage garnishments, liens and judgments) lower your score.
- Even though there may be unfavorable data in your credit report, a recent history showing positive change helps to raise your score.

How much you owe = 30% of your credit score. FICO scores look at the amount you owe on each of your accounts, the number of accounts you have with a balance, and how much of your available credit you are using. The more you owe compared to your credit limit, the lower your score will be.

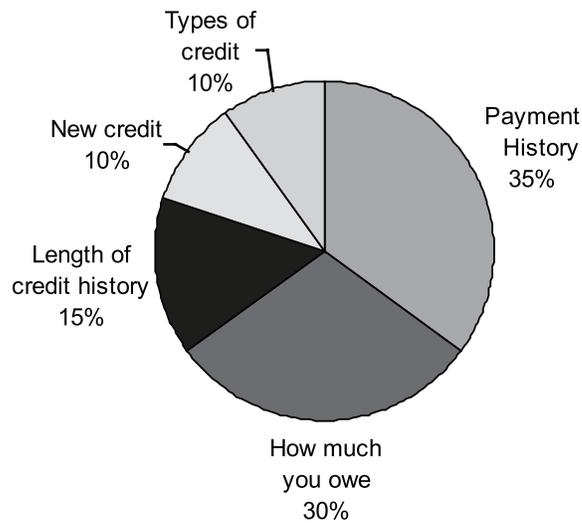
Length of credit history = 15% of your credit score. A longer credit history will increase your score. However, you can still get a high score with a short credit history if the rest of your credit report shows responsible credit management.



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If you need a loan, do your rate shopping within a focused period of time, such as 30 days, to avoid lowering your FICO score.

Credit Scoring Factors

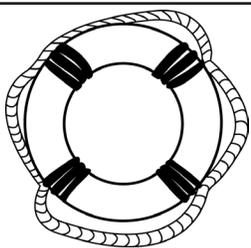


New credit = 10% of your credit score. Applying for several new lines of credit within a short period of time can hurt your credit score. Lenders consider this behavior a sign of greater risk of living beyond your means, resulting in possible nonpayment.

Types of credit used = 10% of your credit score. Having a mix of credit types on your credit report – credit cards, installments loans such as mortgage or auto loan and personal lines of credit – is normal for people with longer credit histories and can add slightly to their scores.



Red Flag: Using finance companies or predatory lenders can hurt your credit score.



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Reviewing your credit report frequently will help you identify potential identity theft or errors. Consider requesting your credit report every four months from a different credit reporting agency.

Building a Credit Record

If you have never used credit, you may have no credit history. There are several ways to establish a credit history:

- Work at a part-time or full-time job for 6 to 12 months before applying for credit.
- Open and maintain checking and savings accounts in your own name. Although these accounts aren't considered "credit," many lenders view these accounts as a sign of financial stability. Time will show that you can handle money responsibly, meet your financial obligations and establish a savings habit.
- Apply for a secured loan at a local lender, using your savings as collateral.
- Apply for an account or credit card issued by a local store. Local businesses are sometimes more willing to extend credit to someone with no credit history. Once you establish a pattern of making payments on time, major credit card issuers will be more likely to extend credit to you.

- As a last resort, ask a parent or friend to co-sign a loan for you. You still need to make your payments on time because failure to do so will harm your credit as well as your co-signer.

Getting Your Credit Report

Thanks to the federal government, consumers in the United States are entitled to a free credit report each year! The Free File Disclosure Rule of the Fair and Accurate Credit Transactions Act (FACT Act), enables consumers to request a free copy of your credit report from each of the three national consumer reporting agencies – Equifax, Experian and TransUnion – every 12 months.

Consumers may request their **free** annual credit report online, by phone or mail.

- For online requests ... go the website www.annualcreditreport.com
- To call toll-free ... dial 1-877-322-8228.
- For mail-in requests, complete the Annual Credit Report Request Form (found online) and mail to:

Annual Credit Report Request Service
P.O. Box 105281
Atlanta, GA 30348-5281

Credit reports or **credit scores** may be **purchased** at a low cost from:

Experian
www.experian.com
1-888-EXPERIAN (397-3742)

Equifax
www.equifax.com
1-800-525-6285

Trans-Union
www.transunion.com
1-800-680-7289

What Information Must I Provide?

To receive your credit report, you will need to provide basic information, including:

- Name
- Address
- Social Security number
- Date of birth. (If you have moved in the last two years, you may also have to provide your previous address.)

To maintain the security of your file, each credit bureau will ask you for personal information which only you will know. (Examples: How much is your monthly mortgage payment? What was your High School mascot? etc.).

What If I Want To Know My Score?

If you have never checked your credit score, consider doing so to have a general idea of how you are doing. Although your credit report is free, you will have to pay a small fee to get your credit score. The fee varies per agency, but is usually less than \$20. This option will appear when you are on the Web site, or you can mail in your fee with your credit report request.

Are There Any Other Authorized Online Sources?

NO! Despite numerous television ads promoting free credit reports, www.annualcreditreport.com is the **only** source of free credit reports authorized by the federal government.

Is the Web Site Secure?

YES! As the official Web site promoted by the federal government, the Web site is secure.



Red Flag: Neither the [annualcreditreport.com](http://www.annualcreditreport.com) Web site, nor the individual credit reporting agencies, will call you or e-mail you to ask for personal information. If you get such a phone call or e-mail – or see a popup ad – it's a scam. Don't supply any information – or click any link in the message! Instead, forward any e-mail that claims to be from www.annualcreditreport.com to spam@uce.gov, the Federal Trade Commission's database of deceptive scams.

Correcting Your Credit Report

The information in most credit files is correct, but errors and omissions may occur. They may be the result of a computer malfunction or human error. For instance, if two people have similar names, credit information could mistakenly be placed in the wrong credit file.

Omissions may also occur if a creditor chooses not to report information about customers to the credit bureau. Creditors such as utilities and landlords sometimes report only delinquent debts, not timely payments.

Since omissions and errors can occur, it is a good idea to check the accuracy of your credit file periodically. This is especially important for those planning a major purchase such as a house or a car. Avoid last-minute disappointments by checking your report at least three to six months prior to making a major purchase.

If you disagree with any information in your file, the credit bureau must investigate and verify it before it can be added or removed. The process may take 60 to 90 days. To insure that the mistake gets corrected as quickly as possible, contact both the credit bureau and the company that provided the information to the credit bureau. By law, both of these parties are responsible for correcting inaccurate or incomplete information in your report under the Fair Credit Reporting Act.

Steps include:

1. Tell the credit bureau in writing what information you believe is inaccurate. The credit bureau must investigate the items in question – usually within 30 days – unless they consider your dispute frivolous. You will want to include copies (NOT originals) of documents that support your position. In addition, your letter should:

- Include your complete name and address.
- Clearly identify each item you wish to dispute.
- State the facts and explain why you are disputing this information.
- Request deletion or correction of the items you are disputing.

You may also want to include a copy of your credit report with the item or items that you are disputing circled. Send your letter by certified mail, return receipt requested, so you can document that the credit bureau received your correspondence. **Keep a copy of your dispute letter and all documents or receipts that you enclosed to support your case! (See Sample Letter 1)**

2. Write to the company with whom you have a dispute.

Again, include copies of documents and receipts that support your position. Again, **keep a copy of your dispute letter and all documents or receipts that you enclosed to support your case! (See Sample Letter 1.)**

Note that many companies specify a special address for disputes. If the company again reports the same information to a credit bureau, it must include a notice of your dispute. Request that the company copy you on any correspondence they send to the credit bureau. Expect the process to take between 30 to 90 days.

If the credit bureau cannot solve a problem, you are entitled by law to submit a brief letter of explanation (100 words or less) stating your side. Your statement becomes a permanent part of your credit file.

Sample Letter I. Dispute Letter (Credit Report Errors)

Date
Your Name
Your Address
Your City, State, ZIP Code

Name of Credit Reporting Agency OR Name of Company (with whom you have a dispute)
Complaint Department
Company Address
City, State, Zip Code

Dear Sir or Madam:

I am writing to dispute information in my file. The items I am disputing are also circled on the enclosed copy of my credit report.

This information (identify specifics of dispute and name of company) is (inaccurate or incomplete) because (describe what is inaccurate or incomplete and why). I am requesting that the above mentioned be investigated and corrected (or request another specific change).

Enclosed are copies of (describe any documents you are enclosing such as payment records, court documents, receipts that support your position). I request that you thoroughly investigate, correct this matter and notify all agencies and companies involved of the results. I also request a copy of any correspondence sent on behalf of this matter.

Respectfully,

Your Name

Enclosures: (List what you are enclosing)

Keep a Good Credit Rating

To keep a good credit rating remember to always use your legal name (no nick-names) when applying for or using credit. A legal name contains the birth-given first name and a surname. There are several legal variations. The variation or form depends on your marital status and your preference. Whichever variation you choose, use it consistently!

Do not overextend your obligations nor attempt to obtain too many credit accounts at the same time. Many creditors have standards concerning the number of credit bureau file inquires that are acceptable over a given period of time. For example, more than three inquires in a 90-day period may cause denial. Having too many credit accounts may also reduce your credit score.

Once you have established a good credit record, guard it. To keep your good credit record, always:

- Read credit contracts thoroughly. Make sure you understand them, and pay back your credit obligations as agreed.
- Contact creditors immediately if you must miss a payment.
- Correct any billing errors promptly.

What If Credit Is Denied?

If you have been denied credit, a lender must notify you in writing within 30 days. Common reasons for denying credit are: too short a period of residency or employment, lack of credit references, insufficient income, delinquent credit obligations and no credit file.

If denial was based on information in a credit report, the lender must give you the name and address of the credit bureau that furnished the report. According to law, the credit bureau must furnish information about the contents of your credit report at no cost if you have been denied credit within the last 30 days.

If any errors were reported and corrected, you may also ask the credit bureau to send a copy of the revised report to any creditor or employer who requested your record within the last six months.

What Are My Credit Rights?

Several credit laws give consumers certain rights: the Equal Credit Opportunity Act, Fair Credit Reporting Act, Fair Debt Collection Practices Act, Fair Credit Billing Act and the Fair and Accurate Credit Transactions (FACT) Act. The following summarizes some of the important points of each act.

Equal Credit Opportunity Act (ECOA)

The Equal Credit Opportunity Act ensures that all consumers are given an equal chance to obtain credit. It doesn't mean that all consumers who apply for credit will get credit. Factors such as income, expenses, debt and credit history are considerations for credit worthiness.

The law protects you when you deal with any creditor who regularly extends credit, including banks, small loan and finance companies, retail and department stores, credit card companies and credit unions. Anyone involved in granting credit, such as a real estate broker who arranges financing, is also obligated to adhere to this law.

The Equal Credit Opportunity Act requires:

- You cannot be denied credit based on your race, gender, marital status, religion, age, national origin or receipt of public assistance.
- You have the right to have reliable public assistance considered in the same manner as other income.
- If you are denied credit, you have a legal right to know why.
- Requires that a credit grantor notify you within 30 days to inform you if your application for credit was accepted or rejected. If you have been denied credit, the grantor must give you a notice that tells you either the specific reasons for your credit denial or your right to learn the reasons if you ask within 60 days.

Fair Credit Reporting Act (FCRA)

The Fair Credit Reporting Act (FCRA) is designed to help ensure that credit bureaus furnish correct and complete information to any creditor who requests your information. Your rights under the Fair Credit Reporting Act:

- You have the right to receive a copy of your credit report. The copy of your report must contain all of the information in your credit file at the time of your request.
- You have the right to know the name of anyone who received your credit report in the last year for most purposes or in the last 2 years for employment purposes.
- Any company that denies your credit application must supply the name and address of the credit bureau they contacted, provided the denial was based on information given by the credit bureau.
- You have the right to a free copy of your credit report when your application is denied because of information supplied by the credit bureau. Your request must be made within 60 days of receiving your denial notice.
- If you contest the completeness or accuracy of information in your report, you should file a dispute with the credit bureau and with the company that furnished the information to the bureau. Both the credit bureau and the company who furnished the information are legally obligated to investigate your dispute.
- You have a right to add a summary explanation to your credit report if your dispute is not resolved to your satisfaction.

The Fair Debt Collection Practices Act (FDCPA)

The Fair Debt Collection Practices Act applies to personal, family and household debts. This includes money owed for the purchase of a car, for medical care or for charge accounts. The FDCPA prohibits debt collectors from engaging in unfair, deceptive or abusive practices while collecting these debts.

Your rights under the Fair Debt Collection Practices Act:

- Debt collectors may not contact you before 8:00 a.m. or after 9:00 p.m.
- Debt collectors may not contact you at work if they know your employer disapproves.
- Debt collectors may not lie when collecting debts, such as falsely implying you have committed a crime.
- Debt collectors must identify themselves to you on the phone.
- Debt collectors must stop contacting you if you ask them to in writing.

Fair Credit Billing Act (FCBA)

The Fair Credit Billing Act establishes procedures for resolving mistakes on credit card statements. Remember, it is important to check your credit card statement each time you receive it. Mistakes can damage your credit status.

The FCBA settlement procedures apply only to disputes about “billing errors.”
For example:

- Unauthorized charges. Federal law limits your responsibility to \$50.
- Charges that list the wrong date or amount.
- Charges for goods and services you didn’t accept or weren’t delivered as agreed.
- Math errors.
- Failure to post payments and other credits such as returns.
- Failure to send bills to your current address – provided the creditor receives your change of address, in writing, at least 20 days before the billing period ends.
- Charges for which you ask for an explanation or written proof of purchase along with a claimed error or request for clarification.

To take advantage of the FCBA’s protection, you must:

- Write to the creditor at the address given for billing inquiries – not to the address for sending your payments – and include your name, address, account number and a written description of the billing error (see sample letter 2).
- Send your letter so that it reaches the creditor within 60 days of when the first bill containing the error was mailed to you.

It is recommended that you send your letter by certified mail, return receipt requested, so you have proof of what the creditor received. Include copies (not originals) of sales slips or other documents that support your position. Keep a copy of your dispute letter!

The creditor must acknowledge your complaint in writing within 30 days of receiving it, unless the problem has been resolved. The creditor must resolve the dispute within two billing cycles (but not more than 90 days) after receiving your letter.

Sample Dispute Letter (Billing Disputes) Sample Letter 2.

Date

Your Name
Your Address
Your City, State, ZIP Code

Name of Creditor
Attention: Billing Inquiries
Address
City, State, ZIP Code

Re: Your Account Number

Dear Sir or Madam:

I am writing to dispute a billing error in the amount of \$_____ on my account. The amount is inaccurate because (describe the problem). I am requesting that the error be corrected, that any finance and/or other charges related to the disputed amount be credited as well and that I receive an accurate statement.

Enclosed are copies of (use this sentence to describe any enclosed information, such as sales receipts, payment receipts or canceled checks) supporting my position. Please investigate this matter and correct the billing error as soon as possible.

Respectfully,

Your name

Enclosures: (List what you are enclosing)

Fair and Accurate Credit Transactions Act (FACT)

The FACT Act provides consumers the opportunity to receive a free credit report each year from each of the major credit reporting agencies (Experian, Equifax and TransUnion). Other specific provisions include:

- Safeguarding receipts by requiring that only the last 5 digits of credit card numbers be printed
- Enabling consumers to “opt out” or block solicitations from companies they do business with
- Requiring banks to inform you if it reports negative information about you to the credit bureaus
- Allowing identity theft victims to block fraudulent information from appearing on their credit reports
- Placing fraud alerts on credit report to alert creditors that your financial information has been or may be compromised

Using Credit Wisely

Credit, like any other resource, must be managed and used wisely. Unwise credit choices can create financial problems that affect other areas of your life such as buying a home or getting a job.

Wise credit management involves a few important steps: know the content of credit contracts, shop carefully for credit, establish a system for handling bills, set a personal credit limit, analyze credit habits and look for ways to reduce credit costs.

Know Content of Credit Contracts

Most consumers are unaware of the content of their credit contracts. Study each one carefully to find these important details:

- Finance charge and how it is figured
- Annual percentage rate (APR)
- Minimum monthly payment
- Penalties for early repayment of a loan or for late payments
- Repossession information
- Responsibilities of the borrower

Shop for Credit

Since the cost of credit varies so much from lender to lender, it is important to shop for credit. The Truth-In-Lending Law requires creditors and lenders to state their credit charges in a clear and uniform manner to make it easier to compare credit costs. According to the law, cost must be expressed in two ways:

Finance Charge – the total dollar amount paid for using credit including interest or service charges, credit report charges and premiums for credit insurance (if required).

Annual Percentage Rate (APR) – The total cost of credit expressed as a percent and based on a yearly interest rate.

The Truth-In-Lending (disclosure) law does not set the price of credit. It only requires creditors and lenders to state their prices.

When shopping for credit cards, don't forget to compare annual fees, late fees, penalties, grace periods and methods of calculating finance charges. Your credit paying style may affect your choice. For instance, a higher interest rate is not as important if you pay bills in full each month.

Set a Personal Credit Limit

If you have several credit card accounts, your total credit limits may exceed what you can safely handle. Keeping track of your total charges, payments and outstanding balances on all of your accounts can prevent problems. Keep credit balances and limits low enough to fit within your income (below 15% to 20% of your monthly income) or an amount that could be repaid in full within 24 months. If you are house hunting, lenders typically like to see that the balance you owe on any given credit card is 40% or less. Of course, the less outstanding debt you have, the better off you will be.

Analyze Credit Habits

It is easy for families to get into the habit of charging most purchases. In some cases, the ease of charging can lead to financial difficulties.

You can break the credit card habit in many ways if it is creating financial problems for you. One technique is to keep your number of credit cards to a minimum. To control impulse purchases, make it a personal rule to use your card(s) only for emergencies. The fewer credit cards and loans that you have, the easier it will be to keep track of your debts.

Look for Ways to Reduce Credit Costs

Many things can be done to reduce the cost of credit. Here are several suggestions:

- Borrow the smallest amount possible by making as large a down payment as you can.
- Arrange the highest monthly payments you can afford. Pay back the loan as soon as you can. Credit costs are less if a loan is paid back in one year rather than two.
- Pay your bills on time to avoid late fees.
- Annual fees can add up! Keep the number of your credit cards to a minimum.
- Shop around for the best credit card deal for your paying style.
- Pay off credit card debts with high interest rates as soon as possible.
- Review bills carefully each month and report billing errors as soon as possible.
- Use credit only when you need it. Planning purchases and paying cash can mean big savings. Most consumers spend much more when using credit than when paying cash.
- Consider several sources for purchases. Many ways of buying are less expensive than using credit cards.

For example, if you want to buy a \$400 TV, you could do several things:

1. You could rent it with an option to buy it. If you rented the TV, you would pay about \$13 per week (about \$56 per month) for about 78 weeks (18 months), making the total cost of the TV more than \$1,000.
2. You could buy it on credit. If you bought it on credit with a 15% interest rate and 18 months to pay it back, your monthly payments would be about \$24.95 or a total cost of \$449.17.
3. You could save up for it. If you saved \$13 per week (the same amount you would pay to rent), you could pay cash for the TV in 31 weeks, which is less than eight months. (In the meantime, you could watch TV on an old black and white loaner from a friend!) If you and your family can wait and can make yourselves set aside the \$13 a week, this is the lowest cost alternative, \$400.

That means your family has \$49.17 or as much as \$600 to spend on something else!

When shopping for the item you want, you need to look for the best buy. Some stores offer low cash prices but charge high credit interest rates. Others have high prices but low interest rates. Most will be somewhere in between. Where you buy depends on whether you are paying cash or using credit.

When to Use Credit

Credit can be very helpful in times of emergencies. At these times, you may have no other choice but to use credit. However, using too much credit can create problems. You and your family have to decide when to use credit and when to use some other alternative to get the things you want.

Stop to ask yourself a few questions before each purchase involving credit:

- How will added payments fit into my present budget?
- Will this item last longer than the payments?
- Will I want this item as much later, when I am making payments, as I do right now?
- Will this item increase income, save time or improve health?
- How much will using credit increase the total cost?
- If I lost my income, how would I make payments?
- Am I using credit for convenience with a sure means of paying later, OR am I using credit because I do NOT have the means to pay?

Generally, credit should be used for things that last longer than the payments. It is best not to use credit for small purchases and everyday expenses.

Adapted from: Reichel, C. (1998). *Your Path to Home Ownership*. Baton Rouge, La.: LSU AgCenter.
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