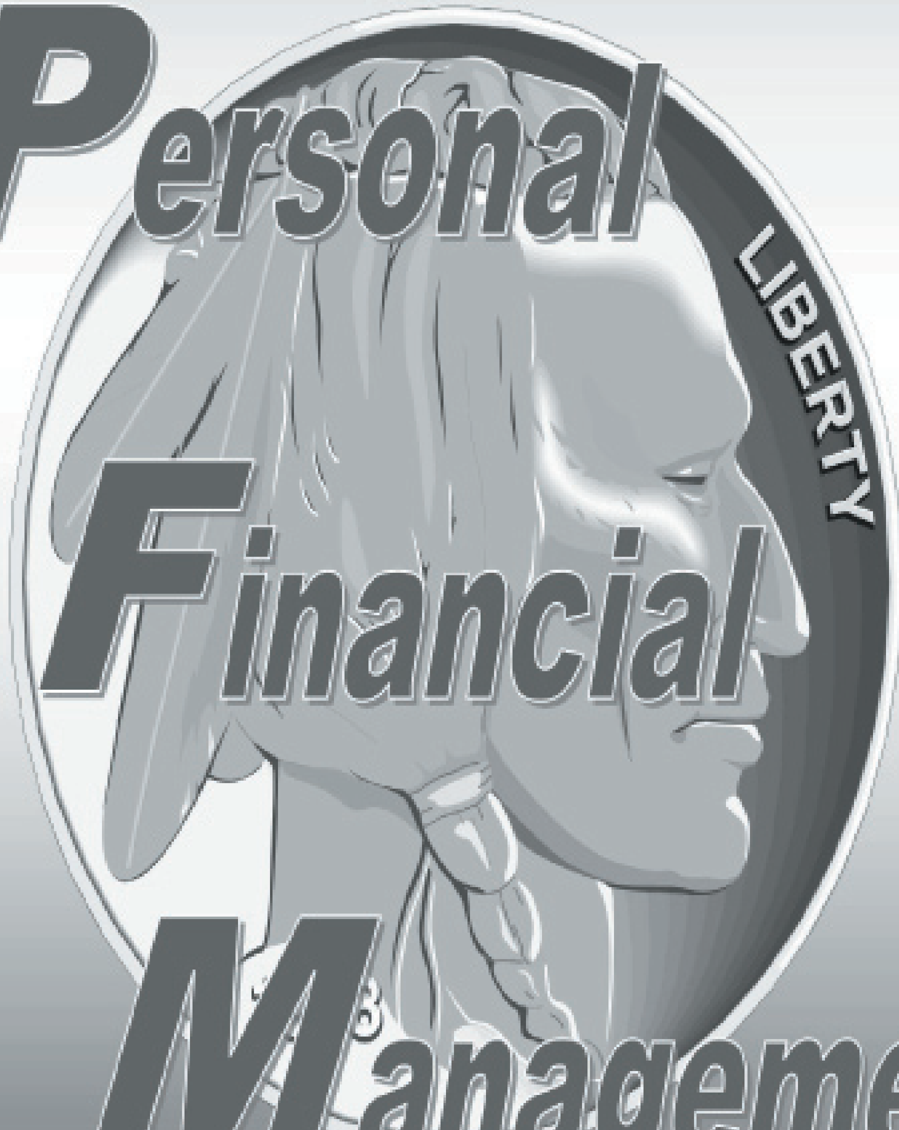
REEFS

Personal Financial Management



Instructor's Manual

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REEFS

Instructor's Preface

Dear Instructor:

This manual is an update of three previous versions and an ongoing labor. It combines the work of many individuals over the past ten years. Originially, this class was called Personal Finance & Investing and included material from both the **Personal Financial Management** and the **Personal Investment Management** classes. Ms. Armstrong (then the Education Director at Wakulla C.I.) asked that the class be separated into two parts and to include more detail. Those individuals just needing the personal finance information could take a class that was focused on controlling their personal finances at home. In putting this class together, information was combined from a number of sources, and we would like to give full credit to all the facilitators and volunteers whose efforts have preceded ours.

Personal finance is one of the most vital subjects in our lives, yet we are not taught much of anything about it in school. We come out of our formal education and are expected to make the right decisions on things that we were never taught. What type of bank account is best for me? How do I budget my money with the future in mind? How long should I run the loan for my car or house? What type of insurance do I need? Will I have enough money to retire when I reach that magical age?

The personal financial management class is one that I believe is vital to anyone who has or **has not** been behind bars. Our financial lives are not just about the money we have today. We need to look at what the money I have today will be worth in the future. In the personal finance class we will look at our personal finances from the viewpoint of budgeting money to make the most out of what I have. We will look at buying a car and a house in an affordable and achievable way. Realize that affording these things does not mean how much monthly payments you have, but what will it cost in total (with the proper down payment, proper interest rate, and proper length of payments). We look at insurance in terms of not what we can get but what we need to properly keep us and our assets safe. Rounding out our financial lives means saving for retirement when we reach the end of our careers. How can we maximize the amount of money we save today to get the most out of it? Part of maximizing that money is not paying any more income tax than we need to pay. Even though we do not teach tax strategies in the class, we do talk about how to save money tax-free.

We show how to use the strategies taught in class while in prison. We also talk about budgeting money while in prison and how to find the best deal on what you buy. Most of all, our goal is to get students to realize that they are in charge of their money! Our aim is to give the students as much knowledge as possible so that they have the power to control their circumstances. There are financial options for everyone. They all have the power to control their financial futures.

Remember:
You control, by your spending habits, where your money goes and how fast it leaves your pocket.

and

Budgeting is telling your money where to go, before you wonder where it went!

INSTRUCTOR TALKING POINT

Throughout this instructor manual there are **INSTRUCTOR TALKING POINTS** for the instructor to read aloud to the class. There are also examples of diagrams and activities for the instructor to use during class, all of these supplements to the student manual will be found in specially designated text boxes like this one.

INSTRUCTOR NOTE

Text in boxes like this one are not designed to be read aloud, but are notes for the instructor to give advice or direction for guided discussions. There may also be suggestions for text or diagrams to draw on the board.

Items set off by this graphic, called **Money Savers**, are key points and should be stressed as important when reviewing the material (either as a class or for the students individually.

Items set off by this graphic are topics which will be covered on the test. The topic itself is underlined next to the graphic.

The following graphic indicates the page number of the Student Manual where the information can be found. It denotes the beginning of that page in the Student Manual:

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REEFS

Welcome to PFM

INSTRUCTOR NOTE

A good way to begin the class and set a tone of quiet is to call the role quietly. This sets the expectation of maintaining this tone throughout the class.

Introduce the facilitators. If possible, mention your experience with finances (good or bad). What problems have you faced and how have you overcome them? What successes have you had and why?

Rules and Expectations:

Class runs approximately 8-10 sessions (at least), depending on security issues and how quickly, we can move through the material. If there is no call-out posted in the dorm, come to the center gate anyway. As we all know, the call-out process is prone to fail.

We are in a unique situation here; there are no officers in the room. Although, there are cameras. We do ask that people be respectful of each other. Don't leave the classroom until the class is dismissed, and we must leave as a group.

All of the class sessions build on the previous ones, so attendance is mandatory. If you have a medical or classification call-out, go to it. Those take priority. If you finish the call-out early, check in with center gate and try to come back to class so that you don't miss too much information.

Questions to ask to inspire discussion as you begin:

What do you expect or want to learn from this class? (write answers on the board)
What does Personal Financial Management mean to us? Does it increase or decrease security for our families?
What financial problems will we face upon release?
What *was* your main source of income?
What is your financial footprint?

Allow discussion here for as long as people need to continue. Going forward, it's important to be able to judge the class to see what level they are at. This can guide you to help determine what areas you need to focus on and which ones can be moved through more quickly. Above all, you want them to feel involved in the functioning of the class itself.

[Write the following on the board]:

A Fundamental Money Management Course
"YOUR Money"
Becoming a smart consumer instead of being a stupid spender!

Key Topics

Discipline & Sacrifice

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Welcome to the Personal Financial Management class. The goal of this program is to teach you the basic skills needed for personal financial management and the accumulation of wealth.

In order to achieve that goal, a solid foundation of knowledge and sound personal financial management principles must be built.

This program will teach you:

- o How to save money!
- o How to effectively use credit and financial products!
- o How to make your money earn money for you!

Throughout the manual, whenever you see a "Money Saver," take note that it designates a thought-changing concept, one you will want to embrace if you are going to be successful at building wealth.

Here's your first **Money Saver**! When your money starts earning money, you then begin to build WEALTH

INSTRUCTOR TALKING POINT

This class is a combination of the efforts of inmates here and at the Annex (when they had classes). That's what REEFS is all about. It was started right here at Wakulla back in 2006 by a group of inmates who realized that Classification, like the majority of the people in the Justice system, view inmates as the problem. They're there to help, but, mostly, they aren't going to go out of their way to do so.

At the time, there was little offered outside of GED and a few chapel classes. While those are important offerings, this group of inmates saw a need and an opportunity. Rather than viewing us as nothing more than crime statistics, why not utilize the lives and legal skills that we bring with us? Every one of us is so much more than the worst things we've done.

That was the vision of REEFS. There are no expensive instructors or materials. It is simply us, helping each other to learn important life and business skills. It is inmates being the solution instead of the problem.

This course was originally created by Jeffrey P. Botsford; the information he supplied was compiled from a seventeen-year career in the bank, brokerage, trust, and private bank industries. It has since been edited by the REEFS team of Mark Tousignant, Ken Blosser, and Jason West with assistance from Henri Zogaib. We strive to keep the material presented as current and relevant as possible with our limited resources. Be aware that the specifics can (and frequently do) change from year to year, but the concepts presented here will supply you with a strong financial foundation to build your future on.

New Manual Team:
Writing & Editing: Mark Tousignant, Ken Blosser, Jason West, Booker Flowers, Henri Zogaib
Graphics: Jason West, Mark Tousignant
Design Layout: Mark Tousignant
Special Thanks to all the volunteers that have helped us with their time, advice, materials, and kind support, including Bette Strickland, Nate Schaidt, Bob McVety, and countless others. Their compassion is appreciated every day.

Note that everyone who has contributed to the creation of this manual is an inmate (with resources and information supplied by volunteers). That is the mission of REEFS: inmates helping inmates to succeed, to give you the best possible chance to never come back to prison. We hope that you will use this information, this chance, to learn everything you can. Help yourselves. Help your families. Make the future brighter than the past.

INSTRUCTOR TALKING POINT

Success in the Financial World has much to do with something that we think about a lot here: respect. But, to have respect in the financial world, you need to earn it. Do we want to live in a sewer or do we want to live in a society and be respected? Many of us have been in that sewer. We were not respected; we were nothing. We meant nothing to a bank or a credit union - no one knew us; we were the janitor and not the customer.

We may have been living in a fantasy and not a reality; we tried what we though was the easy way out, but it didn't turn out so easy. We ended up here. Yet, coming to prison gives us something, too. It's not always a good thing, but we get the chance to start over. Now, we have the opportunity to do it the right way. No one can ever tell you it will be easy - it won't be - but it'll be a lot easier than this. In order to gain the respect we need, we have to do the work.

Then, we'll have a reason to be proud of ourselves.

Every human being has certain things that we want to achieve in life. We want to be safe. We want to be happy. We want not to be alone. Health, happiness, prosperity, family… These are universal goals. But, how many of us actually set out a plan to achieve any of these things? By defining your specific goals, you begin to lay out a path to reach those goals. Our dreams then stop being dreams and become real, attainable things.

Of course, some things we have to experience on our own. We can't make anyone else healthy or happy; those are individual choices that we all have to make. However, the REEFS courses are designed to help by giving us as much needed information as possible to make informed decisions and begin to establish real, specific goals. The Life Mapping course, in particular, lays out a plan to help you succeed in multiple areas of life (health, relationships, employment, and more). This class, Personal Financial Management, is designed to focus on finances, how to build wealth and use it, and, most importantly, how to set a financial goal that can be reached.

Will it be easy? Is anything worth achieving ever easy? It will require a few things that will be mentioned often over the course of this class: discipline, sacrifice, and determination. But, it definitely has value. It's worth noting that the single most common cause of problems in relationships is money. That's because most people don't plan. They don't set a goal, so they have nothing to guide them in financial matters. Most people simply live day-to-day, moment-to-moment, and somehow hope that the future will just magically take care of itself. Invariably, it doesn't. Problems always have a way of showing up at the worst possible time. Having a financial plan means being prepared when they do. This class is designed to give you the definite knowledge you need to gain the power to control your financial life and reach for your goal. Imagine how much less stress it puts on us, individually and in our relationships, if we set that goal, if we respond when situations arise instead of just reacting.

So, what is your financial goal? Do you have something specific in mind? Maybe you want to own a home or a boat or just a really nice car (all *assets* – which we'll discuss later). Maybe you expect to attain great wealth. Take a moment to write down a specific financial goal that you would like to reach. Try to think long-term here. A financial goal could be as simple as "I want to save $10 on my canteen so I can get a Big AZ Chicken Sandwich for my birthday next month", but, for the purposes of this class, we want to think bigger. Think about a financial goal that you want to achieve within 5 to 10 years of your release from prison. For anyone who might not have that option in their future, think about a goal you might want for your family within that time frame. The concepts we learn here can be used by them as easily as by us.

My Financial Goal is ______________________________

____

____

For some people, a goal might simply be "financial security," but what exactly does that mean? Financial security can be defined in these ways:

- **Having a steady source of income** – future income is the bedrock on which financial security is built.
- **Anticipating long and short-term needs** – things have a habit of breaking down, roofs spring leaks, kids get sick or they grow up and go to college, someday you might want to retire.
- **Building our assets** – financial worth is about more than just having money in your wallet.
- **Protection against financial catastrophe** – protecting your assets is the best way to be safe.
- **Getting ahead** – eliminating debt, saving and investing can move you from going backward to going forward.

In this class, we'll look at all these areas. *Our* goal is to give <u>you</u> the tools you need to build a structure to support your goal. As with any construction project, however, if we want to have a stable structure we need to start with a strong foundation.

INSTRUCTOR TALKING POINT

Everything in the outside world is constantly changing. The financial world looks very different now than it did when the original manual for this course was written back in 2011. We try to keep up to date with as many of those changes as possible, but it is inevitable that the material we get printed is constantly playing a game of catch-up.

One area where change is even faster is technology. Paper checks for a checking account are fast going the way of the telephone booth and the dinosaur. Society is quickly moving toward a completely digital, cashless economy. So, we will try to discuss some of those changes during class. Unfortunately, it would take an entire class on its own to go over everything that's out there and how to use it. We will focus on some of the absolute basics that you need to function.

First, and most fundamentally, you need an email account. Ever wonder why you might not get a lot of written letters from everyone you used to know on the outside? That's because most people don't write by hand anymore. They e-mail or text or post to social media. Electronic Communication is where the world is going, and you need to have an email account, at the least, in order to keep up with this.

How do we set up an email account? [Write the steps on the board]

- Internet Access (Smartphone, Home Computer, Library)
- Go to a website that offers free email (Google, Hotmail, Yahoo)
- Personal Info (Name, Address, Phone Number, etc.,.)
- Choose a User Name (BFlowers, KBlosser2016, JWest25)* Note: the '2016' or '25' behind the names are there because the name may already be in use by another person. There are hundreds of millions of people with email accounts and many of them have multiple accounts.
- Choose a password ($milkyway67, 2bruce#37&5, e3^h5%7gg9)* Note: It is important, to prevent identity theft, to create a password that is alphanumeric (using letters and symbols). The less it resembles a real word, the more secure it will be, but be aware that you also have to remember the thing.

Your account will look something like this: BFlowers@gmail.com; KBlosser2016@hotmail.com; JWest25@yahoo.com

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INSTRUCTOR TALKING POINT

The biggest obstacle in financial discipline in everyday life is the *need to want* and the need to have *immediately* without any thought about why you need those things and, more importantly, the consequence. People in society have adopted a deadly culture known as "buy now pay later" without a real understanding of the true meaning of cash, finance, credit, and debt. 80% of society lives without any understanding of what managing your debt and finances should look like, and not understanding the difference between 'cash flow' and 'cash management' could be deeply and seriously harmful.

When living on a limited income, it is crucial to have self-control and to clearly know the difference between *needing* and *wanting*. In this course, we will examine the depth of needs and wants and how to properly pay for them. We will need to face the discipline and sacrifice needed to succeed.

In this course you will learn about **K.P.C**. Those three letters will soon become your favorites and they will change your life.

[**Write the following on the board**]

K= KNOWLEDGE (Homework, do your homework; Diligence)
P= POWER (The ability to execute)
C= CONTROL (The strength to be stable)

INSTRUCTOR TALKING POINT

"*Budgeting is telling your money where to go - so you won't wonder where it went***!" – John Maxwell**

What is knowledge? Is it power? Knowledge is simply the accumulation of facts. 'Understanding' is knowing how to use those facts, and wisdom is knowing when to use those facts. So, *knowledge* is the first step toward *power* and *control*, but it is not the same as those things. We need all three.

As a culture, Americans are ignorant of what money is and how to handle it. In fact, 17% of Americans believe they need to win the lottery in order to meet their financial goals. Ignorance is not a lack of intelligence; it is a lack of 'knowledge.' When I was young, my parents bought me a chemistry set. The first thing I did was not to read the directions. To my parent's credit, they knew their son very well; they had the brains to send me out to the garage before I started mixing chemicals together like a mad scientist. I knew nothing about chemistry. I was ignorant. As a result, the neighbors ended up calling the fire department because of the thick dark smoke pouring out of the garage. How many of us have done the exact same thing with our personal finances? We just dive in without trying to gain the knowledge that will give us the power to control our money and accomplish our goals. We're not ignorant as to how to make money, but most of us have been ignorant on how to spend it with our goals in mind. You don't need to win the lottery (although it would be nice). You just need the knowledge to make your money work for you instead of the other way around.

We were given a lot of information in school; math, reading, writing, science, etc... We were even taught about stuff that most of us will never use again. We had to be able to identify the difference between a Brontosaurus and a Tyrannosaurus Rex. How is that information going to help us in our daily financial lives? Were we taught how to budget? Were we shown bank accounts and credit card applications and taught how to read the fine print at the bottom or on the back of the form? Or more importantly, what that tiny print is really telling us?

Budgeting is not an exciting subject, but you must understand the concept because everything else in this book is useless without this first step. We're going to say two words over and over when it comes to budgeting – sacrifice and discipline. You'll make sacrifices for things that are important to you. If budgeting and saving money are a part of your priorities, you will sacrifice something now for a better future. I'm going to challenge you that maybe you don't have to give up anything, but maybe just change the *way* you do things. What we need to change is the mental muscle between our ears.

In the pursuit of knowledge, your first step is to place the foundational blocks upon which all the rest of your learning will be built. To be successful with your personal finances, you must, first and foremost, understand why a budget is important to your financial success, how to construct a budget, and how to use it effectively. Budgeting is your first foundational block. Once this block is in place, we can move on to lay the rest of the foundation (being a smart consumer, calculating our net worth) and build upward from there.

INSTRUCTOR TALKING POINT

The Budgeted Bachelor

Note: (The Budgeted Bachelor talking points are meant to be as cheesy and non-realistic as possible. These are OPTIONAL. You don't have to use them, but they can generate interest. If you are going through them, really put on the ham and try to sell them like a cheap salesman)

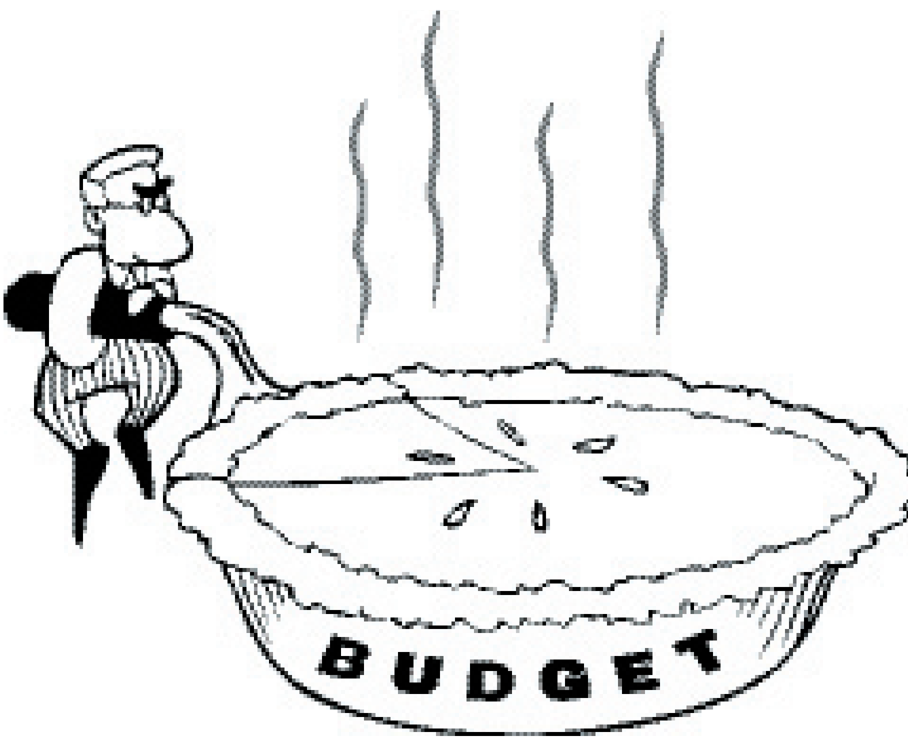
#1 Living on a Budget – 1st date

Devon and his girl are out on a date. He takes her to a fancy restaurant – she knows he's living lean and mean and that he's a pretty thrifty guy – he's not *cheap;* he's *thrifty*. He gets a good table. They're both dressed nicely, and his date says, "These prices are really expensive. Do you think we should really eat here?"

But Devon's a financially literate type of guy – he's got the whole night budgeted, and he's ready. He says, "It's ok. Don't worry. I've got this whole night covered. I'm on a budget!"

Right then and there she knows Devon is a guy who's going to take care of her and always be there. Why? Because he plans ahead. She's going home with *him*.

Why do I need to budget?



It is safe to conclude that if you have responsibilities in your life you worry about money. Did you know that more than half of Americans don't have a basic budget, and 22% say they don't have a clear picture of what they spend on housing, food, and entertainment? Not to mention that more than two-thirds of Americans say they live paycheck to paycheck. That means that at the end of the month, more than six of every ten people in the country are struggling to pay their bills. Without a budget, your financial picture is, at best, muddy. At worst, you might find yourself overspending, racking up credit-card debt, and feeling confused and anxious about your situation. But, a good budget gives you a clear picture of your financial situation so you can live within your means. It will also show you how much you can spend – right down to the dollar – on everything from food ($100? $1,000?) to rent ($500? $5,000?) to travel ($200? $2,000?). And, a budget will keep you motivated and accountable toward attaining your financial goal. You wouldn't walk into a busy street with your eyes closed, yet so many of us walk blindly right toward the edge of a financial cliff.

Budget-keeping is critical because of the ever increasing cost of living and the overwhelming cost of many necessities and discretionary items. If you want to start the process of achieving your financial goal, it's absolutely vital to start living your life using a budget. And, begin the habit now so you don't have to break the habit of not budgeting later. Many people cringe just at the idea of making a budget, but think of it this way: It takes a lot less time and effort to write down a budget and stick to it than it does to scramble for money when you run out with two weeks to go until the next payday. Put another way, writing down a budget is something you can literally do with a bowl of popcorn at your side and some bad TV on in the background.

It's important to understand this fundamental point: Your budget will be very different from that of the person sitting next to you. Your budget will, without question, differ in many key respects from any "average" spending-saving pattern of any "average" American family. That's because the average American family isn't real. The "average" family exists only on paper and its "average" budget is a fiction, invented for statistical purposes. Think of it like height. If you are 6'3" tall, the person on your left is 4'2" tall, and the person on your right is 5'7", the average height of the three of you is 5'3" even though none of you is 5'3". All the "average" does is set the mid-point of the range between you. It's the same with an average budget. Some people will fall far in one direction and others will fall far in the opposite direction. Very few, perhaps none, of the people will actually fit the exact average.

So, the shape of your budget will depend directly on your own, or your family's, individual goals and priorities. Would you prefer to spend $500 on a new video game console or on community college classes? Would $1,000 spent on a new stereo system mean more or less to you than $1,000 worth of, say, guitar lessons? There is no sense in attempting to fit into someone's "ideal" financial pattern which ignores your own personal wants and desires.

The budget you implement will also depend heavily on the makeup of your family. A young working couple without children may have relatively low housing costs, relatively high entertainment and clothes costs, and a good opportunity to save substantial amounts toward future family goals. Drastically different will be the budget of the couple with growing children and a heavily mortgaged house.

KISS – "Keep It Simple, Sir"

Simple and flexible are the key points here. Simple records are more helpful and easier to maintain. All we need is a blueprint for each month's spending, a history of where money goes each month, and an overall picture to help when a financial emergency arises. If you budget down to the individual pencil eraser it will be much harder to make adjustments than if you simply budgeted for "office supplies." And, adjustments will happen. You may want to review your budget every month to see if any changes are needed. Once you've made your budget, stick to it, but remember that a budget should work for you, not the other way around. You should NEVER let a budget become a straightjacket or it will surely fail. Keep it simple to keep making changes from becoming a chore.

The point is that there is no such thing as an average budget and you should not even look for a standardized format. Search instead for a simple, flexible financial outline to help you achieve the goals you truly want. Understand that using a budget can help you to live within your means while achieving your financial goal.

How do I budget?

When you first leave prison, it may seem impossible to live on basic minimum wages. Admittedly, it will be difficult. Let me make the suggestion that it really is just a question of perspective. To put it differently, you may have to check your perspective each time you have a budget issue. Make sure that your perspective on any individual item is in line with your overall financial goal. Let's take a look at how to survive once you are out of prison and how, with sacrifice and discipline, you can live within your budget.

INSTRUCTOR NOTE

The components of a budget are worth going over here. You can write these on the board, but try to define them as you go (with as much input from the class as possible)

- Income: Full-time vs. Part-time. What is the primary source of our income, and is there more than one?
- Expenses: Fixed vs. Variable expenses [discuss the difference]
- Discretionary Income: "He who buys what he does not need steals from himself." What is discretionary income and what should we do with it? It's important to note that this is NOT savings. This is your "walking around money," your "you decide" money.
- Impulse Spending: [More on this later]
- Savings

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Job # 1			Job # 2			Job # 3		
Taco Bell $8.25 per hour			Taco Bell $8.25 per hour			Machinist $18.50 per hour		
40 hrs/ Weekly Income		$330.00	48 hrs / Weekly Income		$396.00	40 hrs / Weekly Income		$740.00
(times 4.33)			(times 4.33)			(times 4.33)		
Monthly Income		$1,428.90	Monthly Income		$1,714.68	Monthly Income		$3,204.20
Less Withholding 15%		($214.34)	Less Withholding 15%		($257.20)	Less Withholding 15%		($480.63)
			Mow 3 lawns on day off at $40 per lawn		$120			
Net Pay $1,214.56			Net Pay $1,577.48			Net Pay $2,723.57		
Expenses:			Expenses:			Expenses:		
41.2%	Rent*	($500)	31.7%	Rent	($500)	27.5%	Rent	($750)
						13%	Food	($350)
						5.5%	Clothing	($150)
						11%	Savings	($300)
						9.2%	Utilities	($250)
20.5%	Food	($250)	15.8%	Food	($250)	2.9%	Probation	($80)
6.2%	Clothing	($75)	6.4%	Clothing	($100)	20.6%	Transport:	($561.94)
7.4%	Savings	($90)	15.2%	Savings	($240)		Lease Payment	($256.94)
10.3%	Utilities	($125)	11.4%	Utilities	($180)		Gas/Oil	($150)
6.6%	Probation	($80)	5%	Probation	($80)		Insurance	($150)
3.3%	Transport	($40)	2.5%	Transport	($40)		Repairs	($5)
4.5%	Discretionary	($54.56)	12%	Discretionary	($187.48)	10.3%	Discretionary	($281.63)
100%	Total	($1,214.56)	100%	Total	($1,577.48)	100%	Total	($2,723.57)

* Does $500 sound crazy for rent? Maybe you might have to get a roommate… Perspective adjustment…How many roommates do you have now? One sounds okay when compared to 70. It's a step in the right direction and it's only temporary.

INSTRUCTOR TALKING POINT

Devon was convicted of armed burglary and just finished a ten-year prison sentence. He's in his late forties now, a very different person than when he started his string of incarcerations. There were reasons for everything that happened in his life, of course, but he's tired of it now and feeling like life is passing him by. He's ready to get out there and walk the straight path now, to start over with a new life. He'll do it better this time. He'll do things the right way.

With high hopes, Devon puts out applications and resumes at every business he can find within five miles of his small apartment. He makes calls, pounds the streets, and does everything he can think of to try to get an interview. Ultimately, he wants to start his own business buying and selling modular homes, but he needs money to get there. And, no one is calling him back. Oh, he gets a couple people to look him in the eye when he shows up in person, but there's always a bunch of hemming and hawing and not a whole lot of eye contact as they promise that they'll "get back to him." After two weeks, Devon is feeling more than a little discouraged.

But, he doesn't give up. Late in the third week, he finally gets a call for an interview. Sure, it's for Taco Bell, but it's an interview! It's a step up, and that's all he needs to start. He's feeling even better when he actually lands the job (and, a full-time shift at that!) and walks home with a spring in his step. Yep, he's on his way!

INSTRUCTOR TALKING POINT

Taco Bell is not going to be the best possible job. Is Devon going to reach his goal of owning a business by working for minimum wage at an entry-level job? Believe it or not, it's realistic. Once we have employment, it's much easier to find other employment. It's also possible to aim for promotion and pay raises in the job we're at. So, Devon isn't starting off in the most glamorous of positions, but his attitude is good. This is his place to start.

So, let's look at Devon's situation with Job #1 in our budgets. He's earning $8.25 per hour and working 40 hours per week. This gives him a weekly income of $330.00. If we multiply his weekly income by 4.33 (4.33 because there are more than 4 weeks in most months - 4.33 being the average) we will get Devon's monthly income of $1,428.90. Is this the amount that he'll take home? Absolutely not. From this amount he's going to have to pay taxes of at least 15% (maybe even higher). What does this 15% include? Social Security, Medicare, and Federal Income Tax (and State Income Tax in some states, but Devon lives in Florida which does not have a State Income Tax) are all included. After all this is subtracted Devon now has a net take-home pay of $1,214.56.

Now he has to decide how he's going to spend it! The first thing to pay is his Rent. Devon's rent is $500. Hold on… what kind of place is he renting for $500? Maybe he has an efficiency apartment or a room? Maybe he found a little trailer or a long-term motel room? Nope. Devon has a roommate, a slob of a guy named Todd.

Wait, wait, wait... Roommate? The last thing I want when I leave prison is a roommate... Right?

INSTRUCTOR TALKING POINT

The Budgeted Bachelor

#2 Rent – The Todd Situation

Sometimes we have to accept the unimaginable; we have to get *a roommate* to help cover the costs of the rent. So what? You can't deal with a roommate? How many do you have here in prison? 72, 86, 96? One roommate? Is that so bad? I know you might be thinking, how am I going to have a girlfriend with a slob of a roommate in the picture? Well, I have a solution.

Devon's walking up the stairwell, and he starts up a conversation with this stunningly attractive brunette. He talks about whatever is going on in his life and is pleasantly surprised by how much she's into sports. He gets to his floor, and she continues to walk with him. He walks down the hall and finds she lives right across the hall! He opens his door, and there, in his SpongeBob Squarepants boxers, with a bowl of Capt'n Crunch on his chest, passed out with drool coming out of his mouth, is his roommate. She sees his roommate and asks "OH MY GOD! Who is that?"

Devon doesn't panic. This is his time to shine; he responds: "Oh, that's Todd, my roommate. He's been going through a rough patch: lost his job, girlfriend left him, and he found out he's allergic to peanuts." He tells her that he's helping him out in his moment of hurt and need. She knows Devon's compassionate, and man has he made some inroads to her heart.

INSTRUCTOR TALKING POINT

Let me give you a little bit of perspective on this roommate thing – how many of you live in an open bay dorm? You now have 70 roommates (or more). Does living in the same apartment with only 2 or 3 other guys really sound that bad? I don't know about you, but having my own bedroom and bathroom will seem like a little piece of heaven. The biggest thing to remember is that this is only temporary. Remember – Discipline and Sacrifice. This is our *first step* toward a more secure future.

The next thing on the list is Food. In Devon's budget, he has $250 budgeted for food. Bear in mind that Devon is single (although, he does have his eye on that attractive brunette). If you have a family, your budget is going to look vastly different. Do you think Devon can live on $250 per month in food? That works out to $8.33 per day. He's not going to be eating out at Applebee's every night or having a lot of steak, but he'll be deciding what he'll be eating. The figure I've heard is that our meals here cost around $2.50 per day. Do you think you can eat pretty well on $8.33 per day? Plus, Devon has the added benefit of working at Taco Bell. He'll be getting at least one meal free or at a discount.

INSTRUCTOR TALKING POINT

The Budgeted Bachelor

#3 Food – Veggie Madness

Man, is food expensive! It's so crazy to try to eat on a budget and get decent quality food. So what are you going to do? As always, *don't panic*! We've got you covered.

The biggest food expenses are decent fruits and vegetables. A simple solution is this, grow your own. Yep, that's right. Grow your own carrots and tomatoes or even potatoes. All it takes is some soil, a pot or bucket, time, and some care. With a little investment of your time and creativity you can be eating better, healthier food that you can take pride in. A great side benefit is that you can build upon the relationship you already started with your girl. Remember the brunette on the stairwell? How? Just listen up, chump.

When Devon's girl comes over and looks past his roommate Todd drooling all over the couch and sees some plants on the patio or by the window, obviously she gets curious. When she asks what those plants are, he simply responds: "Well, I believe in being as healthy as possible and growing your own food is a fantastic way to stay in charge of your health but also strengthen the basic ties to the environment. I also find it is an excellent way to reduce my carbon footprint."

Devon also knows that if he has extra tomatoes or carrots they make a great gift to a lady friend. I mean, really, who's going to turn down free vegetables? There's nothing like locally grown tomatoes, one of the greatest aphrodisiacs.

(Can't afford plants? NO EXCUSE! Just like Devon, you can go to Lowes or Home Depot and ask if they have any plants they've thrown away. Go dumpster diving, nurse a tomato plant back to health, and bang! Instant red deliciousness. No pots, no soil? REALLY?! What is there a shortage of dirt? I don't think so, use an old milk jug or coffee can with some dirt from the park. *Everyone* can grow their own food.)

INSTRUCTOR TALKING POINT

Now we come to Clothing. Devon budgeted $75 per month for clothes. Is he going to be getting the best name brand or new designer clothes? NO! He's getting most of his clothes at Goodwill, Thrift Stores, or yard sales. He has no one to impress. He doesn't have any money so the chicks aren't going to be hanging around him like they used to. Plus, he's not going to have enough money to worry about clothes for clubbing. But, by shopping on the rich side of town he finds really nice used clothes, really cheap. Devon has his eyes on his end goal. Instant gratification is nice, but remember that this is just a stepping stone – Discipline and Sacrifice will get us out of this temporary situation.

INSTRUCTOR TALKING POINT

The Budgeted Bachelor

#4 Clothing – In a Blaze of Thriftiness

With little money, it's tough to find affordable, good-looking clothing. Malls and department stores are way too expensive. You buy one pair of socks, and there goes your budget for the next two months. What's a man to do?

Devon sure isn't afraid. He can find great clothes at excellent prices at the local Goodwill or thrift store. Some of these clothes have never even been worn, and he finds very reputable name brands that are classic items of clothing. Have a problem wearing Goodwill clothes in public? Why? No one can tell unless you leave the tags or stickers on them. Always check your clothes after you buy them for tags and stickers. Nothing is more embarrassing than having your waist and leg length stuck all over the back of your thigh.

If you're wondering how this helps Devon get the girl, listen to this: He just got back from church wearing his Goodwill blazer and khaki pants, looking good, when the attractive brunette sees him in the hallway of their apartment building. Amazed at how well he's dressed up, she asks: "Where did you get that great blazer?"

Devon, being the suave successful budgeted bachelor, replies: "Oh this? I got it on sale." No more needs to be said. He's already spoken enough. The brunette knows he's thrifty, and he saves money. And, that's more money to be spent on her.

INSTRUCTOR TALKING POINT

Look at this next category: Savings. Devon has budgeted $90 – that's only $20.78 per week, less than $3 per day. You probably think I'm crazy, but you have to pay *yourself*. What we do with this money will become clear later. But no matter how much you make, **you have to pay yourself**.

A lot of people see saving as a luxury. The truth is that saving is not only necessary but essential to protecting our budget. When emergencies happen, and we know they will happen, having nothing in our savings will spell disaster. Savings is the anchor to sound budgeting. We'll get more into proper savings techniques later on in the class. For now, know that <u>you must take your savings seriously – pay it like a bill. Make it a requirement.</u>

Now we come to Utilities. $125 isn't a lot of money for utilities. Devon doesn't have cable TV or internet. He just has the basics, nothing fancy. As a bare necessity, he has a cell phone, which you'll also need, and not a simple old-fashioned flip phone. They do still exist, and they're cheap. You can get phone calls on it and receive text messages, but they don't give you all the advantages that you need in today's society.

A Smartphone (while they may be more expensive) is increasingly necessary to function out there. Smartphones are your internet, your computer, your access to electronic coupons and apps, and your gateway to cashless transactions and banking. This is how you stay in touch to keep track of your applications and resumes. Those old flip phones are increasingly obsolete, today's equivalent of having a pager.

So, Devon's utility cost covers some basic electricity, water, and his Smartphone service. He's stuck with a contract, but this is bare bones budgeting… for now. Not necessarily a great way to impress a date, but it's a step in the right direction.

INSTRUCTOR TALKING POINT

<u>The Budgeted Bachelor</u>

#5 Utilities – Tuned into Savings

When it comes to utilities you don't have much to spend. Which means you can't have the A/C on, lights are off in rooms you don't use, and no cable or satellite T.V. What do you do when the woman you've been courting walks in and notices that you don't have the A/C on, the lights are off, and there is only local T.V.? Simple! Remember that you're like Devon - a caring, compassionate man who's in tune with what's environmentally responsible. When she asks, he says, "You know, I believe that Air Conditioning leads people to become imbalanced with what is going on seasonally, and I like to stay linked to the natural cycles that occur throughout the year. It's important to also manage my carbon footprint by minimizing the amount of electrical waste from needlessly having lights on. Cable T.V. is one of the main reasons there's been a downfall in quality television. I watch local T.V. so that I can be aware of what's happening in my community and support my friends and neighbors. Besides, with free-T.V. now you can get all the old movies and music videos you want with (THIS, Bounce, CoolT.V., etc...). Who needs a subscription?"

Man, Devon's a guy who knows how to be savvy, next time Sleepless in Seattle is on T.V. its movie night at *his* place.

INSTRUCTOR TALKING POINT

Devon's been in prison a few times, so he's facing probation when he gets out. His cost is $80. After doing a survey on the compound, the average amount of probation was about $80, so that's the amount we included in Devon's budget. If you have probation, it may be more or less. If you don't have probation, you could add this amount to one of the other categories...maybe savings or food. If you're going to have back child support or restitution and you go in front of a judge for him/her to set the amount that you have to pay, can you imagine what the judge would say if you had a realistic budget to show? He/she would probably be more inclined to show some leniency if you at least looked like you were trying to be responsible.

INSTRUCTOR TALKING POINT

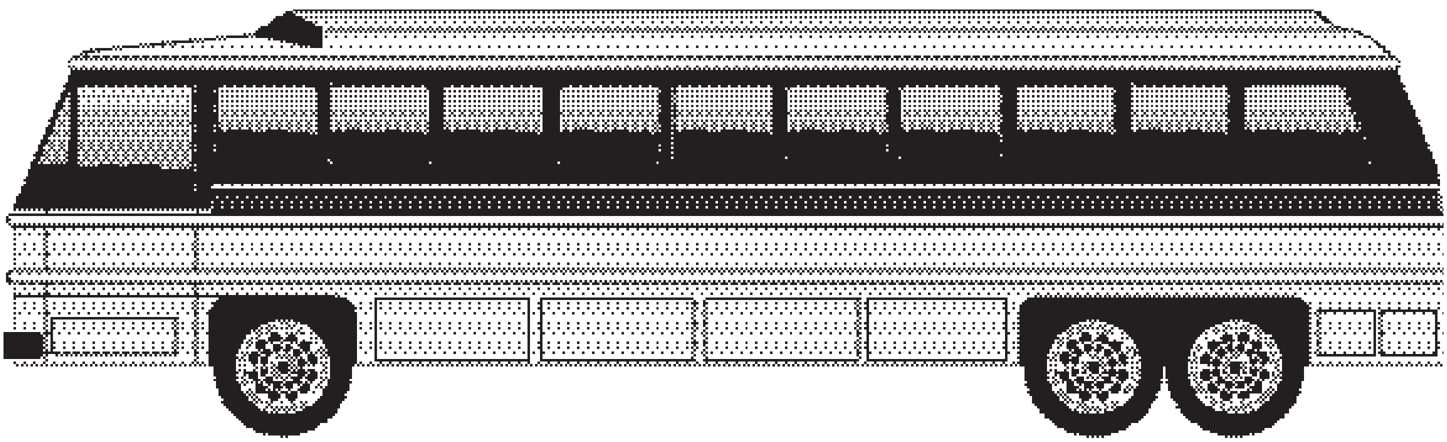
The Budgeted Bachelor

#6 Probation – The Institution of Love

When Devon eventually tells his girl that he's on probation, he makes sure to acknowledge that being responsible is a part of who he is. He tells her that he made some mistakes and learned so much about responsibility in prison. For example: he took a personal finance class where he learned that budgeting for probation is a great way to ensure that he manages his money and freedom successfully so he can remain with the ones he loves and there is no one he loves more than her, which is why every time he writes that probation cost check it is like signing his commitment to loving her.

INSTRUCTOR TALKING POINT

The last item on our list is Transportation. What type of transportation is Devon looking at for $40 per month? Most cities have a bus system, and you can usually get a monthly bus pass for thirty or forty dollars. You could take part of this money and buy a bicycle, but Devon's using a bus pass. Again, I know that this is not the way to pick up women, but it is a way to get around town. Not fancy, but practical. Remember again that this is only temporary and don't forget – Discipline and Sacrifice. Do you think that this amount of available money for transportation is going to affect where we live? Devon's place is probably either near a bus route or close to Taco Bell.



INSTRUCTOR TALKING POINT

The Budgeted Bachelor

#7 Transport – Just a-ridin' down the road try'n to loosen my load, I got seven women on my mind.

It's a tough world on a budget, especially when you're trying to make every dollar stretch. A great way to reduce your everyday costs is to take the bus. Yes, the bus. It goes everywhere, and if it doesn't you can walk the rest of the way.

But, maybe it's too far to walk. Well then, you can get a bike just like Devon. Most buses have bike racks nowadays, and you can double your transportation effectiveness. Worried about your image while riding the bus and peddling a bike everywhere? DON'T BE! Devon sure isn't.

Devon's a man of action and conscious about his effects on others. So he's just off the bus and riding the last couple miles to his destination. He's on probation, so he obeys all the traffic laws and stops at a red light. While he's at the red light he fixes his helmet, shines his mirrors, checks the bell, straightens the tassels, and adjusts the basket. As he's doing all this at the red light, a convertible with a blonde, brunette, *and* a redhead pulls up next to him. Is he embarrassed? Not even a little. He's been exercising himself riding that bike, and man is it showing in all the right places.

So as he's stopped there at the stop light, the attractive women have their top down… of the car that is, so they can get a better look at Devon. Casually and suavely, he looks over and gives them a good "What's going on?"

If they start giggling it's only because they can't believe this good looking guy is speaking to them. They'll probably say something like: "Nice bike!" or "Wow, cool basket!" or "Awesome Tassels!" Devon's response is: "Yep, I'm just trying to do something for the environment and stay healthy." By then, he's probably piqued their interest so they offer him a ride and their phone numbers. He simply replies: "Well I hope you have a big trunk, because I'm gonna put my bike in it." And there it is: not one but three new phone numbers *and* a new way to get around town!

INSTRUCTOR TALKING POINT

This leaves us with the last item on the list – Discretionary. What is discretionary money? This is money to spend the way we want to, what's left over after all our essential bills are paid. Devon has a grand total of $54.56. Wahoo! That's about $1.80 per day. There's not a lot you can do with $1.80. This could also be called 'Walking Around Money' or 'Fun Money.' Out of this you're going to have to buy grooming supplies and other stuff like that. What you want to do is to get to the point where you control your dollars – your dollars don't control you. We'll come back to this later.

INSTRUCTOR TALKING POINT

The Budgeted Bachelor

#8 Discretionary Income – Second date

So, say Devon and his girl need a second date. He's almost out of walking around money (or he doesn't have any more - those two pizzas really ate up his twenty-three bucks). What does he do?

Don't panic. The answer is simple and a sure-fire way to lock him in as the man of her dreams. Pay attention, here it is. For his second date, he tells his girl that he's going to do something special and humanitarian. He begins his date by taking advantage of all the free natural beauty of the local park down by the lake. Devon even lives in the city. Even better! There's a free museum to check out works of art, and they go for a stroll in the architectural parts of town and admire the awesome sights. When they start to feel hungry, well it's time to show her what an awesome guy he is. For their meal, Devon tells his date that he wants to do more than just the normal restaurant. He wants to help give back to those who are less fortunate. Yep, he's going to go to the soup kitchen and volunteer with his date!

And, guess what! The food is free! After this free fun-filled day date, Devon's spent ZERO dollars, and he looks like a million bucks in her eyes.

Remember, budgeting is not about punishing yourself. It's about being "creatively cheap."

Remember that our examples are just sample budgets. They represent three possible scenarios, but your own personal budget will look very different. Do you have child support? Medication? Are you married? All those things will add things to your budget. Food cost, for example, will be very different for a single man than for one who is supporting two children. Maybe you don't have probation costs to look forward to. Your budget will likely look very different from our examples, but the concept is the same. Break down your expenses and then determine where sacrifices can be made.

> **Discretionary Income**
>
> *After all the necessities are paid, the money you have left over to use is called "discretionary income." This is your "walking around money" to cover the little expenses that come up, things we might want or forgot we needed.*

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Which System of Budgeting Should You Use?

You can look to others for guidance here. The small business owner has part of the answer in the way he handles his store's income and expenses, and combines the two together with some money left over for "emergencies." Your parents had part of the answer in the way they measured their income, and then divided their spending into so much for essentials, so much for savings, and so much for discretionary income. The corporation has much of the answer in the ways it keeps its books, prepares for bad as well as good times, and provides a cushion for the unexpected and the unpredictable.

What you need is a style of budgeting that will:

- Tell you how much money is coming in during the next several weeks or months.
- Tell you how much money has to be put aside today for future security, your independence, and those big unavoidable bills due in the next several weeks or months.
- Tell you how much is left over for the day-to-day expenses ranging from food to a new household gadget.
- Tell you too how much money is left, if any, for discretionary spending.

- Relate your income and expenses for a reasonably long period of time, so that you can avoid living hand-to-mouth, and paycheck to paycheck.
- Help you to run your personal affairs the way most successful businessmen run their businesses.
- Achieve your financial goals.

Money is earned to be spent. Money never remains just coins and pieces of paper. It is constantly changing into the comforts of daily life. Money can be translated into the beauty of living, a support in difficult times, an education, or future security. It also can turn into a source of bitterness. But, when you spend, you buy more than material things such as bread or shoes; you make decisions which determine your whole way of life. Your decisions bring you closer to, or perhaps send you further away from your goals and ambitions.

It may seem that so many of your decisions are forced by circumstances and that you have very little chance to control your own money. Perhaps, however, your income appears too small to go around only because you did not take into account the "nibblers" – the little items that nibble away at your income until there is nothing left. Perhaps you have debts left at the end of the year only because you ignored the "bouncers" – the big expenses that turn up a couple of times a year and make giant dents in your income. Or perhaps you are in trouble only because you haven't considered the "sluggers" – the unexpected expenses such as sickness, or major household repairs, which can throw even a good spending plan way off balance.

INSTRUCTOR TALKING POINT

I'm pretty sure I know what a 'bouncer' is, but what the heck is a 'nibbler'? We came up with terms like nibblers, bouncers and sluggers to help you remember the concepts involved. Let's take a closer look at the first one – nibblers. Nibblers are small impulse buys that add up over time.

Ken works hard. Every day, he's on the road heading to work and back, but he doesn't earn a lot. He's able to afford a car, but it doesn't have A/C. Unheard of in Florida, I know, but it was a great deal and it's got a nice sunroof to cool it off a little. On the way home one day, he stops at the grocery store to pick up some things his wife asked him to grab. He goes down the aisles, picking up the things he needs. He's a very careful shopper; he checks prices to try to save money. He uses coupons and buys in bulk. He goes down the snack aisle and grabs a 6-pack of 20 ounce Mountain Dew. What does this 6-pack cost? It costs somewhere in the neighborhood of $3.99.

Ken keeps on shopping and gets ready to check-out. The temperature outside is 99 degrees and something like 98% humidity, and man does it ever feel good in the nice cool store. But, as he gets close to the checkout lines, there are the front windows, floor to ceiling, and he can actually see the heat out there. It's like he can see people melting as they walk to their cars. Just seeing it is making him start to sweat again. To counteract this small vision of hell, the store has kindly placed a beautiful cooler that looks like a small igloo, smack full of ICE-COLD MOUNTAIN DEW. Just the thought of it is enough to make Ken sigh and feel cooler. One of those would sure help while he's driving home in that heat box he bought. How much does that ice-cold Mountain Dew cost? It's on sale at the low, low price of $1.59. He picks one up with a smile and heads out into the blazing summer heat armed with a nice cold Mountain Dew.

How much did the Mountain Dews in the 6-pack cost? 65 cents. Ken paid almost an extra dollar ($0.94) for the privilege of having one cold Mountain Dew. We can rationalize it in our minds because it's hot outside; we are only going to do it this one time because we deserve it, right? These are nibblers. What do you suppose it does to our budget? Summer in Florida seems to last about 26 weeks. If Ken bought just one extra Mountain Dew a week for those 26 weeks to counteract the heat in his boiling car, it would cost him a total of $24.44. That may not seem like a lot, but numbers like that that can break a budget. You do have Discretionary Income, but if we look at the first Taco Bell budget, that 36 dollars is well over one month's spending money.

Let's look at another example:

Booker goes to MyWay Subs and behind the counter is a great looking 22-year-old young lady who smiles and says, "Welcome to MyWay! How may I help you?"

Booker orders a 6-inch turkey sub with cheese, lettuce, tomato, and mayo. The cute girl asks if he'd like to double the turkey on that. Trying to impress her, and not wanting to look like a cheapskate, Booker replies, "Sure!"

INSTRUCTOR TALKING POINT

Then, the girl lays on a fantastic, sexy smile and asks if he wants to double the cheese or add bacon. "Give me the works," says Booker. He just took a $3.49 sub and spent $5.19. Remember, that $5.19 was just for the sub. Never mind the chips and the drink. Imagine if Booker does that three times per week. At three times a week for a year it ends up costing Booker an extra $265.20 per year just to look good in front of the MyWay girl. Now don't get me wrong, if you budgeted for this it's fine, but if you haven't you just blew your budget. Now, you're in trouble.

What if you smoke? If cigarettes cost you $3.75 per pack (and we may be going back in time there) and you smoke a pack per day, this is going to cost you $113.66 per month. If you were to stop smoking and started investing the money at 8% that means you would have $1,406 after the first year. After 20 years, if you continued to put the money into a conservative investment your balance would grow to $59,088.

The next term is 'bouncers.' These are the items that we know are going to come around every year. They always show up, but somehow we always forget them. This could be car tires, car batteries, any items that seem to sneak up and punch us in the gut (financially speaking).

If we know they're coming, how do they sneak up on us? What do you think the leading day for an Air Conditioner to fail is in the average American home? July 4th, and only if you have a party scheduled at your house that day. When you have a party scheduled, you're A/C unit seems to know and gets mad because you didn't invite it. So, you call up the A/C repairman and he says, "Sure I can come fix it, but today's the 4th and I'm going to have to charge you double time-and-a-half." His rates are already high. Now, they're through the roof, but he's sitting back just waiting for someone to call.

The last term is 'sluggers.' These are items that come out of left field like and blindside us like a right hook. When you get hit with one of these you have a hard time recovering from them. Has your roof ever started leaking at a convenient time? Have you ever gotten sick just when you had plenty of money to account for taking some extra time off? Sluggers are items that are going to come around – we don't know when but they *will* hit us.

INSTRUCTOR TALKING POINT

The Budgeted Bachelor

#9 Making sure you account for nibblers

So, there's Devon standing in line at the local Save-A-Lot, and a *really* attractive girl is standing behind him. He gets the distinct feeling that she's checking him out. Now remember, he's on a budget. As he's standing there, he sees the ice-cold Coke in the fridge by the register. It's flippin' hot outside, and man would a nice ice-cold Coke be great. So, Devon reaches into the fridge and grabs an ice-cold Coke.

As he's reaching into the fridge, the attractive girl says, "Excuse me, but could you get me a Diet Coke out of there?"

"Sure," Devon replies.

Typically, like Devon, you'll spend extra money when you're shopping. Devon simply budgets for it. Because he's a forward-thinking guy, he has no hesitation in being a gentleman and paying for her Diet Coke. BAM! He got a phone number.

Money Saver! Start out with the idea that no amount of money you earn will ever be enough to pay for everything you desire. Accept this theory: the more income you have, the more you will want. If there's something you want badly enough, you will sacrifice other things to get it!

Take the time to think out your own ideals of living and your goals for the future. Develop a plan of control over your spending. Then you will make progress toward the kind of living that means the most to you.

INSTRUCTOR TALKING POINT

It doesn't matter how many new toys you have – someone will always have a new or better toy. Say you just bought a new Ford Fusion. It has all the bells and whistles on it. It has leather interior, a CD player with a 10-CD changer, chrome rims, insulated cooler can holder, power everything. This car is everything you can think that you ever wanted.

You pull up to a four-way stop sign and coming at you on the left hand side is a brand new Blue Ford Mustang. You look over at the Mustang and your head drops as you think to yourself, I could have had one of those if I just had a little more money.

Let's look at things from the Mustang driver's point of view. Remember I said it was a four-way stop? He looks over at the Ford Fusion driver and kind of smirks and laughs to himself – "Yea, I got everything I want," he thinks. He looks to his left, and what do you think he sees? A brand new Red Corvette. The driver of the Mustang looks at the Corvette and just knows that the Corvette can blow his doors off. He hangs his head – now he's not satisfied with his really nice car. Remember I said this was a four-way stop?

The Corvette owner looks to his left and what do you think he sees? Slowing for a stop is a brand new Ferrari. The point is this: it doesn't matter what car or item you have, it will never be good enough or new enough to satisfy us for long.

Personal Budgeting System

Your personal budgeting system, no matter what your future income may be, needs to do four things:

- **Tell you where your money it is coming from** – and when it is coming.
- **Provide for the necessities first, then the comforts and self-improvements, then the luxuries** (when you have the money to spend for them).
- **Give you a means for saving** – a plan to pay off debts or to keep out of debt. Work toward having at least six months' income saved for an emergency fund.
- **Build good habits for spending** – for today and tomorrow.

A sample income statement and budget sheet is included in the appendix of this book for your use when released from prison. We encourage you to take a good look at them and take some time to fill it out (in pencil) with realistic ideas in mind of what your income and expenses will be. Being able to see the hurdles in front of you is the first step to leaping over them.

Job #1		
$8.25 per hour		
40 hrs/ Weekly Income		$330.00
(times 4.33)		
Monthly Income		$1,428.90
Less Withholding 15%		($214.34)
Net Pay $1,214.56		
Expenses:		
41.2%	Rent	($500)
20.5%	Food	($250)
6.2%	Clothing	($75)
7.4%	Savings	($90)
10.3%	Utilities	($125)
6.6%	Probation	($80)
3.3%	Transport	($40)
4.5%	Discretionary	($54.56)
100%	Total	($1,214.56)

As we start out, the reality, for most of us, will be that we don't like what our budget tells us. The ideal situation is to arrange your spending as follows:

- 20-30% on housing
- 15-30% on food
- 3-10% on clothing
- 10-20% on savings
- 4-7% on utilities
- 6-30% on transportation
- 2-8% on medical costs
- 2-4% on other necessities
- 2-20% in discretionary (or entertainment) spending

Most of us don't exactly live in an ideal world. The money coming in might not realistically fit those percentages, and we may have additional budget items, especially if we have people to support. What we need to remember, then, is that the ideal above is a goal to aim for. Let's take a look again at the first budget we mentioned, working minimum wage for Taco Bell... We were left with $23.65 in walking around money for the entire month, not a terribly exciting amount of money, and on the very low end of our 2-20% goal. But, once you know the truth of your financial situation you can start trying to make your budget work for you. Unfortunately, the reality is that there are only two ways to change your budget. You can:

1. Increase your income, or
2. Reduce your expenses

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Job #2		
$8.25 per hour		
48 hrs/ Weekly Income		$396.00
(times 4.33)		
Monthly Income		$1,714.68
Less Withholding 15%		($257.20)
Mow 3 lawns on day off at $40 per lawn		($120)
Net Pay $1,577.48		
	Expenses:	
31.7%	Rent	($500)
15.8%	Food	($250)
6.4%	Clothing	($100)
15.2%	Savings	($240)
11.4%	Utilities	($180)
5%	Probation	($80)
2.5%	Transport	($40)
12%	Discretionary	($187.48)
100%	Total	($1,577.48)

Option #1: increase your income

Sometimes, this one is easier to face.

The reality check is that you either need to get a second job, or improve your education/work skills and find a higher paying job. In our second budget example, by working one extra day on a side job and one extra shift, your income increases by $362.92 per month. Even with budget increases on clothes, utilities, and savings, the amount of your walking around money more than tripled. If you work harder, or smarter, your budget improves. That may not really be a drastic increase, but you're eating better, living a bit better with your utilities, and, most importantly, you're able to save a lot more. Remember that if you are living in this type of a situation, your emergency fund is even more important. Building up a safety margin quickly is key here.

INSTRUCTOR TALKING POINT

Let's take a look at the second budget:

Devon's still working at Taco Bell, and his manager is a pimply-faced, snot-nosed little punk named Horace. And, he just loves to throw his 'weight' around. He goes around calling Devon pops! But here's what Devon does... when Horace comes in and says someone just threw-up in the bathroom and he needs someone to go clean it up, Devon's the first one to go do it. When Horace says that the grease trap needs to be cleaned out, Devon's the first one to volunteer. Devon quickly becomes his most valuable employee. As we say in Employability class – You need to make yourself the company's most valuable asset. If anyone calls in sick and Horace needs someone to work the extra shift, there's Devon, glad to come in early, work late, or work on his day off. So, Devon's main short term goal is to try to get about 48 hours per week.

Do businesses like Taco Bell like to give out overtime? Definitely not. But, on the other side of that, there's usually always an extra shift to pick up. Horace also has a good relationship with the Burger King down the street. He talks to the manager regularly and, eventually, the topic of their workers comes up. Horace can't come up with enough good things to say about Devon. The Burger King Manager, as it turns out, needs someone to cover two short shifts during the week, strictly part-time. Horace makes an arrangement to "loan" him Devon for the two shifts if he has an employee that he can use at Taco Bell for a few pick-up shifts during the week as well. It's a win-win situation for them. They have their vacant shifts covered by employees that have already been vetted by a trusted source, and they don't have to pay a dime of overtime.

Does this sort of situation ever happen? All the time. It's one way that small stores cover overtime without having the high costs of paying out time-and-a-half. So, with the extra shift, Devon's weekly income from Taco Bell is now $396.00 times 4.33 and you get $1,714.68. There are still taxes, of course, which come to about $257.20. That will leave us a take home pay of $1,577.48.

INSTRUCTOR TALKING POINT

Devon still doesn't have enough money to do much, but he still has a couple of days off work (and evenings). On one of those days, Devon goes out into the neighborhood and asks his neighbors if they need their lawns mowed. He's using some of his clothing budget one month to buy a small lawn mower to mow a few lawns on one of his days off. He only mows 3 small yards per month at $40 each. This increases his income each month by an additional $120. That may not seem like much, but this gives me a grand total net pay of $1,577.48. Not to mention the extra exercise he needs after eating too many tacos.

Now let's look at his monthly budgeted expenses and see how *they* changed:

- As you can see his **Rent**'s the same. He's still living in the same crappy apartment with Todd.
- His **Food** budget stayed the same, as well.
- But, the good news is that he can really start buying clothes now. He increased his **Clothing** budget to $100 per month.
- **Savings** went to $240 per month! Is that realistic? The thing to remember is to always pay yourself first. Yes, this number can be adjusted, but remember that this number also represents our lifeline. The more money Devon can put in savings, the faster he can reach his goal of starting his own business.
- **Utilities** also went up even though he's not at home as much. That gets him a slightly better phone and some cable T.V.
- The biggest thing to look at here is **Transportation** – it didn't change. Why would Devon not go out and immediately buy a car? It would probably be because he's still working on building up his credit and it's not quite good enough yet. Nor is he ready to handle the extra expense that goes along with it. We'll talk more about the true cost of owning a car later.
- Look at his **Discretionary Income**. It went to $187.48 per month. That's sounding a little more reasonable. It's still not a ton of cash, but it's over $6 per day. What can Devon do with that money?

In the first budget, Devon's Discretionary Income came to $54.56 per month after all the bills were paid. If he disciplines himself not to waste that money on beer, cigarettes, drugs or any other thing of little to no value, and maintains that discipline for 12 months he would have $654.72. So what? Even if we have discipline to save the money and keep it, that money does nothing if it only sits in your pocket.

<u>**A good strategy would be to invest that money, put it into a vehicle that earns you a profit, money, income, wealth**</u>. We'll talk more about this later on, but keep in mind that your money should be working for you rather than the other way around.

While we're here, let's go back and take a quick look at the third budget back on page 8. Here, we're looking at someone with a trade skill. Some of you may fall into this category. We have someone who's a machinist here. This person is working 48 hours per week at $18.50 per hour. This means a weekly income of $740 and a monthly income of $3,204.20. When we take taxes out, at 15% that leaves us with a net pay of $2,723.57.

What do his expenses look like? His rent is $750 per month. That's definitely a much nicer place than Devon had. He probably doesn't have a roommate and doesn't have to worry about where his car is parked at night. And, with a car payment of $256.94 per month, he has a pretty decent car. That's certainly not the total cost of owning the car, though. He's also got to worry about gas, oil, Insurance, and repairs/maintenance. He's accounted for it all in his budget, though. He also has more food money, savings, clothing, and much nicer utilities. On top of all that, he's very comfortable with his Discretionary Income. This type of job leaves you a lot more room to make adjustments. This may be the goal for many of us, even if we need to start out at the Taco Bell job while we finish up our training or keep looking for that plum job as a Machinist.

Job #3		
Machinist $18.50 per hour		
40 hrs/ Weekly Income		$740.00
(times 4.33)		
Monthly Income		$3,204.20
Less Withholding 15%		($480.63)
Net Pay $2,723.57		
Expenses:		
27.5%	Rent	($750)
13%	Food	($350)
5.5%	Clothing	($150)
11%	Savings	($300)
9.2%	Utilities	($250)
2.9%	Probation	($80)
20.6%	Transport	($561.94)
	Lease Payment	($256.94)
	Gas/Oil	($150)
	Insurance	($150)
	Repairs	($5)
10.3%	Discretionary	($281.63)
100%	Total	($2,723.57)

Truthfully, few people manage to put 20% of their income into savings. Depending on how old you are when entering the workforce, however, this situation may be something to look at carefully. Retirement isn't impossible even if you start late, but it takes a lot more discipline and sacrifice.

Option #2: Reduce your Expenses

The other way to change your budget is to reduce your expenses and when you are already living lean that can prove to be more difficult. However, difficult is not impossible. One way to reduce your expenses might be to become a smarter consumer. Let's take a closer look at how to do just that by looking at some key areas of our budget.

INSTRUCTOR TALKING POINT

What we need to develop is Power over purchase instead of allowing our purchases, and the people from whom we make the purchases, to have power over us. We must remember that we can *always* spend more than we can make.

As consumers, we need to stop being so lazy in making our purchasing decisions – since as a result of our laziness we are often sold goods and services by juvenile tactics and strategies. Remember the K.P.C.'s? This is where we start to gain the Knowledge to exercise Control over our decisions. It is those decisions that give us the Power. Never underestimate how much power you truly have as a buyer.

Food is typically our second largest expense (right behind Rent), so it's a good idea to look at and think about how we spend our money at the grocery store. Are we a wise consumer or a stupid spender?

Food

Human beings have three basic needs to survive: water, shelter, and food. Food, therefore, is a big part of your budget each month. It's not something we can skip if money gets tight. But, there are some ways to manage and reduce your food expenses.

<u>Keep a Shopping List</u>

Post the list on your refrigerator door or somewhere handy in your kitchen. Write down the foods you need during the week or month. Before going to the store, check your list and think about those items you need to have and those you would like to have. When you get to the store, buy *only* the foods that are on your list. That doesn't mean that you're strictly limited to buying only the basic necessities. The point here is to decide what luxuries you can afford *before you go to the store*. This limits our urge to buy on impulse and lets us avoid those 'nibblers.'

Eat a meal

Eating before going shopping will help you to avoid buying unnecessary foods that looked or smelled good because you were hungry. It should come as no surprise to anyone that grocery stores (especially large chain stores) are ready for you. However, few people realize the extent of the research they conduct in order to influence you and your spending habits. Most large companies spend thousands upon thousands of dollars in what is called 'psychological marketing.' Forewarned is forearmed, so here are some of the tricks they have learned from all this research. See how many you recognize...

INSTRUCTOR TALKING POINT

How many of us have done this? We get ready to go to the store and leave the house with no real idea of what we're going to buy. We have no list, and we are hungry at that. What about here in prison? Do you ever go to the canteen window without a list? Or, maybe you do have a list but the guy ahead of you buys a honey bun or some cookies? Maybe he gets a pizza or a cheeseburger, and you can just smell it cooking. You skipped breakfast to get some extra sleep, and man does that pizza ever smell good. Some cookies would go great with it, too, with a little Sprite to wash it down. You don't have any of that on your list, but you're going to the canteen window instead of going to chow. You're hungry so you say 'what the heck' and get the pizza, cookies, and Sprite. You normally wouldn't have bought it, but it was an impulse item and you gave into that impulse because you were hungry.

Impulse Spending has a huge effect on our budgets, here and on the outside. Even if we aren't actively trying to destroy our budget and our financial plan, we are still at risk of doing so every time we don't control our impulses. In here, it happens every time we don't make a plan and then stick to our guns. On the outside, it's even worse. 'Grey charges' are charges that are incurred without our full knowledge. A good example is signing up with a special offer from the cable company that includes a free subscription to a magazine. The catch is that the magazine is only free for 3 months. Then, they bill you for continued service unless you cancel within 30 days. Charges like this that require you to 'opt out' instead of 'opting in' can turn into budget killers, even if it's only $30. If you don't do your homework, these types of charges can lead to automatic withdrawals from your bank account without your knowledge, which in turn leads to overdraft fees, late fees, etc…

On top of that, those big box stores are multi-billion dollar industries. They have lots of money to spend on trying to find new ways to get you to part with as much cash as they can possibly convince you to part with. If you think they're above using tricks on you, let's look at a few examples:

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Psychological Marketing:

1. **The Locked Door Behind You**: Grocery store doors are usually one-way. Once inside, you'll have to walk past a few "special offers" to find the exit. It's like when the frail, screaming victim in a horror movie realizes the only way out of their current environment is through it. Instead of killing you, grocery stores just want to sell you some Oreos.
2. **Fresh Cuts**: Did you forget your girlfriend's birthday, *again*? No problem. The grocery store greets you with just what you need and *lots* of it. First impressions are important and the bucket garden of tulips right inside the front door says, "You've come to a fresh place of earthy joy." There's also a theory that sensory stimulation overwhelms us. It fries our mental motherboard and makes us more susceptible to impulse buys.
3. **Dollars and Scents**: Speaking of stimulation – know how when you get within 10 square miles of an airport or a mall, you can smell the kiosk selling cinnamon rolls? And how you would now knock over grandparents and small children for a taste? The bakery serves that purpose at the grocery store. The grocer stimulates your appetite with one the world's most primal intoxicants: the smell of baked bread. It urges you to shop with your stomach, not your budget conscious brain.
4. **Got Milk?**: Remember in the '80s when, as an aspiring break dancer, you signed up for the free boom box? All you and your legal guardian had to do was sit through a six-hour sales pitch on timeshares in Mexico. Same concept here. We all really want milk. It's among the top three items that any given person goes into a grocery store to buy. Grocers are willing to give it to you, but only after they walk you through their *entire* sales pitch. There's a reason that the dairy section is always at the very back of the store.
5. **Center Stage**: The center aisles with the name-brand goods are the most profitable. That's why items necessary for life – like cereal and coffee – are placed in a middle aisle. And they're often in the middle of that middle aisle. That way, no matter which direction you come from, you'll be exposed to half an aisle of stuff you didn't even know you needed until right now.
6. **Shuffle the Deck**: Face it. Most of us go back to the store for the same 10 items every few days. Doing so, we could easily develop our own "route" through the store and walk on autopilot when we enter the door. That's why grocers 'shuffle the deck.' The crate where the apples have been for the last couple months? Now it's seasonal blueberries for $50 a box (or two for $80!).
7. **Fill 'Er Up!**: Aside from those planning for a zombie apocalypse, very few people need a shopping cart as enormous as the one the store supplies. But here's the thing. If humans are put in charge of a hole, we have a psychological need to fill it. That's why the shopping cart has doubled in size over the years, and those little

carry baskets are intentionally hard to find.

8. **The Right Stuff**: Americans "read" the world from left to right. Our eyes are always moving in that direction, left to right, or toward the natural progression of the "story". So that's where supermarkets often put the items you're most likely to buy, on the right-hand side.
9. **Eye Bombing**: Not that we're lazy people, but we are. We buy mostly what's at eye level, so that's where grocers put their high-profit margin stuff. The bulk economy foods are almost always on the bottom shelf, next to the boxed wine. And, any cereal with a cartoon character who looks stricken with emotional issues? They're placed at eye level for your kiddo, who is now struck with a desperate, loud, crying need for sugar-spackled grains.
10. **Freebies!**: People come into the supermarket "on a mission." It's in the grocer's best interest to encourage you to slow down, hang out awhile. Pausing for free nibbles helps. IT also whets your appetite.
11. **Make It Rain**: How convenient. They let you put money into your pocket as soon as you walk in the door with that shiny new ATM (or two!) located just inside the airlock at the front of the store. And now that you're so terribly wealthy, you may as well splurge on that gourmet bottle of olive oil.
12. **Tuning In**: Studies show that you tend to move to the beat of music when you hear it. So, speed metal is out, and Air Supply is in. Let's slow dance.
13. **Fun Size Tiles!**: Those square tiles of linoleum that people use to cover the floor generally come in a standard size. If you happen to have an odd-sized floor, there's a nice cutting tool for shaping the tiles. Those square linoleum tiles that tend to be on the grocery store floor? They're 1/3 smaller. This tricks the eye into thinking you're moving faster than you are. Result: You slow down and look around more at all that stuff you "need."
14. **Clockwork Oranges**: The majority of people have a tendency to move around large spaces in a clockwise direction. That's why all the grocer's best tricks are located to the right as you enter the store. That's also the way the aisles are arranged, to funnel you toward the best deals... for the grocery store.

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This is not, believe it or not, an exhaustive list. But, it should give you an idea of the kind of effort that businesses will put in to influence your buying decisions. It's not just the flashy advertisement designed to convince us. Good marketing includes every aspect of the purchasing process. Be aware that the manipulation is going on, and you will be in a much better position to resist it.

Shop around

Comparison shopping means you compare prices on similar products. Compare the price of the same food item in different stores. Compare one brand to another even in the same store and try to buy the brand with the lowest price. For example, one brand of eggs may cost less than another, and as long as the quality is good you may want to buy the less expensive brand. Many grocery stores offer "store brands". In today's marketplace "store brands" are often times very comparable in quality to name brands yet are less expensive. Cheaper still are generic brands. These have no company name on them at all and usually come in plain black and white wrappers.

Sales

Sales are a great way to save money. Most grocery stores post sales pamphlets near the front of the store. Pay attention to these, and see if any of the items you want to buy are on it. You might be able to get a better quality item due to a sale or buy more of the usual item and stock up. Two things to bear in mind when shopping for food items on sale:

1. Canned foods can be stored for many months. You may want to buy extra cans of foods you regularly use when they are on sale.
2. Never buy foods that you do not really want just because they are on sale. That would be a waste of your money. If you aren't going to eat it, it's not a good deal no matter how cheap it might be.

Coupons

“It used to be that if you stood in line at a grocery store with coupons, you felt that the people behind you were judging you negatively – you felt like a penny pincher,” says Dan Ariely, a leading behavioral economist and author of *The Upside of Irrationality*. “You were right; they were judging you...”

Times have changed. After declining for more than a decade, coupon use rose sharply in October 2008 as the economy collapsed, and it soared 27% in 2009. Today, the use of coupons crosses all economic barriers thanks to Internet couponing sites like Groupon, TV shows like *Extreme Couponing*, and simple necessity. In fact, the primary drivers of coupon growth are affluent households with six-figure incomes. The rapid spread of smartphone technology and online apps also allows anyone to use coupons with much greater ease and less time investment than in generations past. That said, 75% of people still prefer to use paper coupons, and you will always find them in the Sunday paper.

But, what can we do with coupons? Consider this story from *Money Magazine* (2011):

Lauren Ligget, a 22-year-old college student from Carthage, Mo., found herself hooked the moment she saw the pilot episode of the TLC reality show Extreme Couponing in December. She began scouring the Internet for couponing websites, bought copies of the Sunday newspaper for the circulars, and headed to the grocery store to shop for her family – her mom, Joyce, a realtor, and her dad, Larry, a retired IBM engineer who works part-time as a car salesman. The Liggetts are not struggling financially – they have a low-six-figure income – but since Lauren lives at home and her parents are paying for college, she wanted to help out. On that first shopping trip, she presented her coupons to the cashier and felt the adrenaline rush of watching her total drop from $263 to $50. “Pretty good for my first time!” she recalls.

Today Lauren has slashed her family’s monthly grocery bill from $400 to $100, and the bulging cupboards, pantries, and spare room can make the Liggetts seem like survivalists bracing for nuclear war; 288 rolls of toilet paper, 80 jars of tomato sauce, and 40 bottles of men’s body wash.

There’s no baby in the house, but Lauren couldn’t resist buying 30 containers of infant formula on sale for $3.78 each. Because she had collected piles of $5.00 off coupons, she earned a $1.22 store credit on each sale – the holy grail to serious couponers. (She used her credit to buy ribs for a Memorial Day feast and donated the formula to tornado victims in nearby Joplin.)

Think about this: Why would you pay full price for something when you have the option not to? The stigma of couponing is all but gone now, and using coupons is a smart way to save lots of money.

SNAP

SNAP stands for the Supplemental Nutritional Assistance Program (formerly known as Food Stamps). Like coupons, people can sometimes feel a stigma with using food assistance. However, we should never let pride stand in the way from accepting help when it’s needed. When first starting out, we generally need all the help we can get, and SNAP can be an enormous benefit in helping us to afford enough food and also in our budgeting.

Can ex-cons qualify for SNAP?

Yes, with some exceptions. As of 2016, people convicted of drug trafficking, running from a felony warrant, who break Food Assistance Program rules on purpose, who are non-citizens without a qualified status, and some students in colleges or universities are not eligible for food assistance benefits.

There is an application process, which you can begin by visiting the website for the Florida Department of Children and Families. If you do not have computer access, you can call them to request an application by mail. You will be asked about your income, living situation, expenses, etc. You will also need your Social Security number and a way for DCF to contact you.

Job #1		
$8.25 per hour		
40 hrs/ Weekly Income		$330.00
(times 4.33)		
Monthly Income		$1,428.90
Less Withholding 15%		($214.34)
Net Pay $1,214.56		
SNAP assistance: $194		
Expenses:		
41.2%	Rent	($500)
6.7%	Food	($81)
8.2%	Clothing	($100)
16.5%	Savings	($200)
10.3%	Utilities	($125)
6.6%	Probation	($80)
3.3%	Transport	($40)
7.2%	Discretionary	($88.56)
100%	Total	($1,214.56)

What amounts can an ex-con qualify for?

If you are eligible and approved, you can receive up to $194 per month for yourself.

Healthy adults, who are 18 to 50 years old and do not have dependent children, can only get food assistance benefits for 3 months in a 3-year period if they are not working or participating in a work or workfare program. As of 2016, you are eligible if you earn less than $23,544/year ($31,860/year for couples).

SNAP can be a vital resource for us. As we said, food is one of the essential things we need to survive. Because of this, it's also usually one of the largest expenses in our budget. Looking back at our first Taco Bell budget, we would definitely qualify based on our income of $16,710.36 per year. If we received the maximum $194 in food assistance benefits, let's look at how that would affect our budget:

Our food expense went from 21.2% of our budget to 6.9%, and we were left with $194 to distribute in other areas. We bought $25 more food, raised clothing, got some better utilities, increased savings and still had more discretionary money left over. Our financial burden has been eased considerably.

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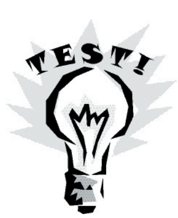
The Unit Price

INSTRUCTOR NOTE

Unit Price is a pretty basic topic, and many stores include the unit price on the price stickers with every item. It makes it vastly easier as a consumer. Plus, Smartphone apps exist to allow people to simply scan the barcode with their phone and compare the prices between several different items and items at several different stores. That makes all this vastly easier than it has been in the past.

However, it's still important to understand how unit price can affect the value of any item we purchase. Stores still want you to buy the most expensive item, so they will use tricks like varying the unit description on the labels. For people just starting out on the outside, this is an important thing to be aware of that many of them may not have thought about before. It's also useful to people who are here using the canteen. You'll need to judge the class to tell how detailed you should get with this. You may be able to just touch on the topic then move on. Other classes may need to get a bit more detailed. It's advisable to at least go over the canteen comparisons as this usually generates a lot of interest in the students (they can relate to it directly). Always be aware that there is math involved in this section, and some students may struggle with that.

Key point: Making a budget first involves knowing what you are spending your money on and how much it truly costs.

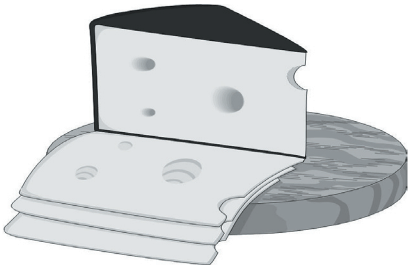


Smart consumers often make purchases with an eye toward the unit price of a product. <u>The unit price is the price of one ounce, one pound, or some other measurement of a product</u>. If you break a product down to its unit price it will help you to compare price values. Most grocery stores show the unit prices on the product label. Here are the unit pricing labels for two containers of salad dressing. Notice the parts that are labeled.

Ranch Dressing
12oz
.10 per ounce **$1.20**

Ranch Dressing
18oz
.08 per ounce **$1.44**

To save money, compare the unit price of different brands and different sizes of the same product. Many times you will find that the unit price on a larger sized product is lower. If you can consume the larger size while the product is still usable then it makes sense to buy the larger amount. Here's an example:



A 2 pound block of Swiss cheese costs $3.84.
There are 16 ounces in a pound.
A 2 pound block is 32 ounces.
$3.84 divided by 32 ounces equals 12cents per ounce and that's the unit cost.

Swiss Cheese
2 pound
.12 **per ounce** **$3.84**

A ½ pound block of Swiss cheese cost $1.28.
There are 8 ounces in a ½ pound.
$1.28 divided by 8 ounces equals 16 cents per ounce and that's the unit cost.

Swiss Cheese
1/2 pound
.16 **per ounce** **$1.28**

Instead of buying a ½ pound block of cheese each week at the grocery store for 16 cents per ounce it might make sense to buy the 2 pound block for 12 cents per ounce and properly store the cheese to make it last four weeks. Let's do the math and figure out how much you save by buying the larger block of cheese. If you buy the ½ pound of cheese each week it will take four weeks for you to eat 2 pounds worth. $1.28 times 4 equals $5.12. $5.12 minus $3.84 (the cost of the 2 pound block of cheese) equals a savings of $1.28. In other words, by buying the larger block at a lower unit cost you ended up with a free ½ pound of cheese. And, that's just one item in your grocery cart.

Some stores don't offer the unit price on their labels so here's a couple examples for you to practice on.

Buffal-Oats
32 ounce
$8.00

Captain Crispy
18 ounce
$5.40

1. The unit price (price divided by size) of the 32-ounce box of Buffal-Oats cereal is __________.
The unit price of the 18-ounce box of Captain Crispy cereal is _______.
The better deal on cereal is the ________ ounce box.

Far and Clean
4 ounce
3 PACK **$0.96**

Orange Breeze
5 ounce
1 bar **$0.35**

2. The unit price of the 4-ounce bar of Far and Clean Soap is _________.
   The unit price of the 5-ounce bar of Orange Breeze Soap is _________.
   The better deal on soap is _______ .

These particular tools are not just useful at some point in the future, either. Budgeting and being a smarter consumer are skills that can help us right here. Make a list before going to the canteen and stick to that list. We may not have a lot of choices between brands while we are at the mercy of a monopoly, but if you want to put what you have learned to the test, take a look at the list of sandwiches available at the canteen. Compare the unit cost per ounce for each sandwich and figure out which one offers you the best value for your money.

Try It Out!

We may not have a lot of choices between brands while we are at the mercy of a monopoly, but if you want to put what you have learned to the test take a look at the list of sandwiches available at the canteen. Compare the unit cost per ounce for each sandwich and figure out which one offers you the best value for your money.

INSTRUCTOR TALKING POINT

Just what do the unit prices at the canteen look like? They tell us the size of the items we're buying, but they certainly don't break it down for us. Do they overcharge us for basic items? We all know that. 70 cents for a ramen soup? Really? But, how much of what we buy do we really think about? Let's take a look at just what some of our canteen purchases are costing us.
[**Draw on Board - Ask for prices as you go to get input. You can even alter items if they know the price of different things. Prices are as of 6/2016.**]

Canteen Unit Prices - How much are we really paying?

Item	Size	Price (incl. tax)	Unit Price
No-Bonz Chicken Wings	5 oz.	$3.89	$0.78/oz.
French Bread Pizza	5 oz.	$3.19	$0.64/oz.
Ham & Cheese	4.5 oz.	$2.80	$0.62/oz.
Big AZ Chicken Sandwich	9.2 oz.	$4.73	$0.51/oz.
Beef Charbroil w/Cheese	4.85 oz.	$2.25	$0.46/oz.
Beef & Bean Burrito	5 oz.	$2.00	$0.40/oz.

What is it exactly that we're paying for when we purchase a hot sandwich? We're paying for it to be heated up. Prepared food costs more. It's as true in here as it is outside. Not only are you paying more for the convenience, but you're also paying tax for the convenience. Purchasing food that we prepare ourselves is almost universally cheaper (and healthier).

Cooking

Cooking can be a lot of fun – if you take it seriously it can become an art form. Aside from that, it's also a another way to save money on the foods you regularly eat. As an example, cooking a large pot of soup is a lot cheaper than buying cans of soup. When we purchase prepared foods, what we pay for is the convenience of not having to put the meal together ourselves (and for the brand name). And, we can pay a lot for that convenience. Learning some simple, easy recipes can save a lot of that money as well as being healthier for us.

INSTRUCTOR TALKING POINT

So, how much do we save off the canteen if we go with a goulash and cook our own meal? Let's take a look.
[**Draw on Board - You can substitute your own items for the ones shown or ask the class what they use for a goulash and price it out. Prices are as of 6/2016.**]

Goulash - How much does it cost?			
Item	**Size**	**Price**	**Unit Price**
Fritos	4 oz.	$1.41	$0.35/oz.
Sour Cream & Onion Chips	1.5 oz.	$0.99	$0.66/oz.
Cheesy Refried Beans	4 oz.	$1.74	$0.44/oz.
Soup	3 oz.	$0.70	$0.23/oz.
Jalapeno Cheese Squeeze	2 oz.	$0.70	$0.35/oz.
Mustard	0.25 oz.	$0.03	$0.12/oz.
Ketchup	0.25 oz.	$0.02	$0.08/oz.
Tuna	3.53 oz.	$2.15	$0.61/oz.

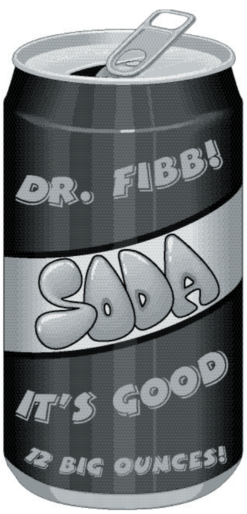
When I make a goulash, I use 1/2 a bag of Chips, Fritos, and Refried Beans. I use 1 soup (either as a sandwich or crushed up), 4 Mustard packets, and 2 Ketchups. I mix in 1 Tuna pouch and 1/2 of a Velveeta Cheese Squeeze. How much does this work out to for one bowl?

Goulash - Part 2 - How much is one bowl?		
Item	**Amount used per bowl**	**Cost per bowl**
Fritos	2 oz.	$0.70
Sour Cream & Onion Chips	0.75 oz.	$0.50
Tuna	3.53 oz.	$2.15
Cheesy Refried Beans	2 oz.	$0.88
Soup	3 oz.	$0.70
Jalapeno Cheese Squeeze	1 oz.	$0.35
Mustard	1 oz.	$0.12
Ketchup	0.50 oz.	$0.04
Total Cost for one tuna goulash special (13.78 oz.):		$5.44 or $0.39/oz.
Total Cost for one Goulash Lite (no tuna, fritos, chips) (7.5 oz.):		$2.09 or $0.28/oz.

42 cents per ounce for my own meal is only a little more per ounce than the cheapest hot sandwich out of the canteen. It's also a lot more food (nearly 9 more ounces). It's like getting 2-3/4 burritos. If I go the cheap route (which, granted, is basically just soup and beans), it comes out to significantly less money per ounce (almost 10 cents less) than the burrito, and it's still 2.5 oz. more food. Put another way, it's like getting another 1/2 burrito for only 22 cents (as opposed to one dollar more for an additional half of the prepared version). Cooking for yourself, even here in prison, is a much better value than paying for the convenience of prepared food.

Go with the big guy

It may seem like an odd recommendation after our discussion about psychological marketing (which is far more extensive at larger supermarket chains), but buy the majority of your food at large supermarkets. They usually have better prices than smaller neighborhood stores. Particularly useful are large discount stores (Save-A-Lot, for example). It might seem like wholesale stores where you can buy in bulk are a good option for saving money, and they can be. However, it depends on what you're buying. If you shop at a wholesale store, you need to particularly aware of unit price. They are not always cheaper, and you need to be sure to compare units that are the same. Let's look at one example:



Sale-Mart

Dr. Fibb Soda
12 ounce can
$0.25

CostLo Wholesale Club

Dr. Fibb Soda
24-pack
$6.48

Many people just assume that the larger size package is a better deal at a wholesale store. But, one way to confuse people is by making the listed unit different from what is on the label at another store. In this case, we're comparing cans to ounces. Going by the label, you might try to break the price down into the cost per ounce. What if we just use '*one can*' as our unit, though?

The cost of one 12-ounce can of Dr. Fibb Cola at Sale-Mart is 25 cents.
The cost of one 12-ounce can of Dr. Fibb Cola at CostLo Wholesale Club is 27 cents.
Buying the cans individually at Sale-Mart is actually the better deal.

By making the correct comparisons, you can find the best deals. But, always remember to shop around. Just because a store is cheaper for a few items, does not mean that they are cheaper for all items.

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Let someone else cook

One last recommendation, if it's possible, is to eat at Mom and Dad's house once a week. They'll enjoy spending quality time with you, the food will probably be great, and you will save a little bit of money on your food budget. Everyone wins. It might be a good idea to suggest that you'll share the cooking responsibilities, though.

Food is one of the basic necessities of life. There's simply no getting around that fact. However, by shopping smarter we can learn to reduce our expenses. But, what if we're not buying something so basic as food? Do some of these tips still work? Believe it or not, clothing is not a basic necessity for survival. We need it, obviously, but our choices in what to buy and wear are largely cosmetic. It's not based on what we *need* as much as it's based on how we *want* to look. So, let's look at how some of these tools can work in this situation.

Buying Clothes

Jacob needed a new pair of work boots. He went to the mall and saw a pair of boots he really liked. Unfortunately, the boots cost $80 and he only had $50 budgeted. Jacob decided to wait. Two weeks later Jacob returned to the mall and saw the boots on sale for $65. The next day he went on the Internet and found the exact same pair of boots for sale on a website for $48. Jacob was proud of himself for shopping around, sticking to his budget, and being a good shopper.

Comparison shopping works regardless of what you might be buying. From food to clothes to houses, look at other stores or areas and compare the price. Sometimes you see a shirt, pants, or pair of shoes you must have… that's understandable. If you get hired to work construction starting tomorrow, you will need the pair of work boots right away. You'll just need to adjust your budget in other ways or dip into your discretionary money to get them. However, many of your everyday clothes needs are predictable.

Make a list. Most people like to have a certain type of socks, underwear, t-shirts and so on. To the extent possible, buy your everyday clothes using a plan.

Wait for sales. At the end of winter, winter clothes go on sale. Summer clothes go on sale at the end of the summer. By waiting for these sales, you can save serious money. You can save money by buying clothes that are well-made, too. They cost a bit more, but well-made clothes last longer and look nicer even after they have been washed many times. Speaking of washing clothes, here's something else to consider. Read the labels of the clothes you buy. If you have a sweater that requires washing in cold water, and shirts that require washing in hot water, that means separate loads in the washing machine which costs extra money. If you say "screw it", and wash them all together in hot water, the sweater that should have been washed in cold water will not last long. Having to replace that sweater prematurely, because you didn't take proper care of it, means wasted money. Checking the label before buying also helps you to avoid "dry clean only" clothes. Dry cleaning is expensive!

One last way to save a lot of money on clothing purchases is one that some people don't like. Thrift Stores. By buying used clothes, you can get a huge discount (as well as helping out a charity in the process). But, what kind of clothes can you get at a thrift store? If you have the option, use the same idea we started with and shop around. The clothes available at these kinds of stores vary widely depending on location. A Goodwill store near a college or an affluent area of town will often have very nice and even brand-name clothes at a huge discount.

Coupons. Are there coupons for clothing? There are discounts available for just about anything even if they don't work just like food coupons. Rebates are particularly useful, if you take advantage of them. Many products today will offer "instant rebates" (which are essentially coupons), but the standard rebate offers are another psychological trick. They do save the consumer money by refunding a portion of what they paid for the product. However, most people don't take the time to send in the rebate form. By requiring the consumer himself to do part of the work, they know that a large percentage of them just won't bother. Don't be like those people. Take the few minutes required to send in a rebate form if one is available. It's money back in your pocket; and why would you say no to that?

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Everything Else

What about the rest of our purchases? We'll go into greater detail about buying cars and houses later, but the concepts of being a smart consumer can apply to anything. Shelter, for instance, is another basic necessity for human life. Even if we're homeless, we need some sort of shelter from the elements. If you need to cut your expenses, and you have a mortgage, you need to ask yourself some serious questions. Needing a roof over your head is not the same as needing to cover it with 3,000 square feet of house. Do you *need* that high-priced SUV or could you get by with a more affordable sedan? Think about what you would like to have, what you absolutely need to have, and what you can afford. Our financial reality might not reflect everything we wish for, but what you can afford should fall somewhere in between wants and needs.

Smart Consumer Shopping Checklist

"Too many people spend money they haven't earned to buy things they don't want to impress people they don't like."
- Will Smith

When you shop you want to be a smart consumer and get the best value on each and every product that you buy, whatever that product might be. To be a smart consumer, ask yourself these questions when you shop.

1. Do I really need this product, right now?
2. Do I have enough money in my budget to buy this product?
3. Do I need to buy this product with credit or can I save up and buy it with cash?
4. Could I save money by waiting for a sale?
5. Are there coupons available in the newspaper or on the Internet for this product?
6. Would this product cost less in a different store?
7. Am I buying this product only to impress other people?

INSTRUCTOR TALKING POINT

The Budgeted Bachelor

#10 – Thriftiness and beyond

Two more points to think about for our budgeted bachelors...

As you're getting ready for a date later on in the week you may need some new threads; so why not stop by the Goodwill or thrift shop to see what's arrived? There's nothing like showing up in a classy new blazer and pants for a fun night on the town. Once again if asked where you got it, you simply got in on sale.

When you go to pick up your date, it's always nice to have some flowers. Flowers can be crazy expensive, which is why it's always a great idea to grow some of your own. Yeah, they're pretty to grow, but eventually they will die. So, why not use them to help you get a date? The next time you go on a date, you can show up with a bouquet of flowers that you grew yourself!

INSTRUCTOR TALKING POINT

The reality is that most people spend a lot of money trying to impress other people. Is it nicer to have a Casio watch or a Rolex? Why is that? Ultimately, how we live is our decision, but we need to use all the knowledge at our disposal in order to make the best decisions possible. Can we get a Rolex? Sure. If we budget for it. Living outside of your means is the best way to throw yourself right into a financial sewer. In our story about Devon, we stressed a couple of things. One of the most important things that you should take away from it is that Devon was able to make sacrifices in the short-term to prosper in the longer term. Does he ever manage to open his own business? It takes a lot of startup capital to do that, but he's definitely off on the right foot.

Once we have the knowledge about why we're making our buying decisions, and about how sellers operate to try to separate us from even more money, then we can start to exercise real control over our financial choices. In the end, we have the power. KPC...

Everything we've discussed so far in this chapter is useful (and even vital) for managing your money. From budgeting to being a smarter consumer and limiting your expenses, all of this can be used to stretch your budget as far as it will go. But, what happens when our budget can't stretch any further? What happens when a situation comes up that we just didn't plan for? When our budget breaks, it's very important to sit down and make whatever adjustments you can, to do what you need to do to fit your new situation. A lot of the time, that means borrowing money (either with a loan or with credit). Which, of course, leads us into...

Debt (What you owe)

A debt is a liability that you have taken on and that you must repay in the future. It can also be a scary word for a lot of people. If you have debt, know that you are far from alone. According to Federal Reserve Statistics, as of December 2012, U.S. consumers held $849.8 billion in credit-card debt. That's between $7,000 and $15,000 per household.

But, not all debt is bad. We can differentiate between good debt and bad debt: Bad debt is debt that doesn't help you make money later but just puts you further in the hole. Good debt, on the other hand, is a means to an end - an investment in your future.

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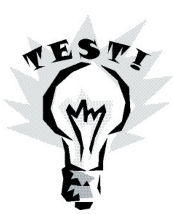
Tackling debt can feel overwhelming, and we'll discuss how to do that in detail later on. First, you need to take an honest look at how much and what kind of debt you have. Write it all down in one place. When listing debts, be sure to include only the unpaid balances. Beyond good and bad, there are two types of debts:

Good Debt	Bad Debt
Debt with a **low interest** *rate, usually taken on as an investment in your future.*	*Debt with a* **high interest** *rate that does not represent an investment in your future and loses value over time.*
Mortgages	**Personal Loans**
Business Loans	**Car Loans**
Student Loans	**Credit-card Debt**

- 1. **Current Debt** is debt you must pay within one year: credit card debt, unpaid bills such as utilities, past due rent, cable TV, cell phone, insurance premiums, and so forth.
- 2. **Long-Term Debt** is due beyond one year's time and usually exists on larger assets, such as your home or car. The largest debt you ever take on, and the longest-term debt, will probably be the mortgage on your home.

That number can look very high when it's all written in one place, but don't panic. There is a way to manage that. For the moment, let's move onto a much more fun topic...



Assets (What you own)

Assets can be anything you own that has monetary value. This could be a car, a home, a checking account, a savings account, CD's, IRA's, 401(k)'s, antiques, household items... anything that has a sellable value. It should also include cash (what is in your emergency fund as well as what you have on hand. All of these things are assets.

While we're on the subject of cash, let's spend a moment talking about what you should have in your wallet. It's recommended that you never carry more than $100 to $200 and two credit cards around in your wallet on a daily basis. It can make us feel important and impressive to be able to pull out a huge stack of bills, but the likelihood of losing your wallet (or having it stolen) is a lot higher than we usually like to think. You'll want to have some cash and a credit card at home to tide us over until we're able to replace everything. Also, don't carry receipts around, because there is a lot of identifying information on there. Don't carry gift cards unless you are using them, because they are just like cash and can't be replaced if lost. Most importantly, don't carry your Social Security number around. Something you *should* carry in your wallet: a cute picture. Crazy but true: studies have shown that if you include a baby or puppy photo in your wallet, you have a much higher chance of having it returned if someone finds it.

INSTRUCTOR TALKING POINT

Remember, when we're looking at assets we should be thinking about the fair market value of our items – not any sentimental value they might have. When you look at real estate for example: you want to put down the actual market value of the property, not what you paid for it or what a real estate agent may want you to ask for it. Keep in mind that a real estate agent makes money only by selling your property, so they're going to inflate the actual worth. If they can get more for it, great, but when we write out a list of our assets we need to be realistic.

When we look at valuing a car – get a copy of the National Automobile Dealers Association (NADA) book a see what the actual book value is on the car (or look it up at *nada.com*).

Cash on hand, checking accounts, money market accounts, all these have a value with no debt or liability associated with it. Household items are the place where most people tend to overstate their net worth. If you buy a new sofa for $500 – a year later is it still going to be worth $500? It probably has a value of less than $100 in much less time than that. Those types of items lose their value extremely fast. When you look at personal items that have been left to you by a loved one – we all have a tendency to overvalue those types of items because of the sentimental value. But what we have to look at is what we could realistically sell these items for. If we were to sell off everything today, what would we be able to get for it?

Just like with out budget, we need to write down what our debts are and what our assets are. Write it all out on paper.

Once you have your assets written down, take some time to estimate the actual value of each item. With cash, that should be easy. It's simply dollar for dollar. Other items might take more thought. When you estimate the value of an asset, it's important to record it using a fair market value and not what you paid for it, or what you think it will be worth in a year. It definitely shouldn't be based on what you *feel like* it's worth. The fair market value can be more, or less, than the price you paid for a given asset depending on what others are willing to pay for that asset, right now. Remember, these should be current values.

Net Worth (A measure of wealth)

INSTRUCTOR TALKING POINT

Do you remember the story about driving up to the intersection in our new Ford Fusion? When we saw the Mustang, we realized we didn't have what we really wanted. Then, the guy with the Mustang saw the Corvette, and the guy with the Corvette saw the guy with the Ferrari. They all wanted more no matter what they actually had. We have to develop financial maturity. It is not an option.

So, there's a vast difference between being wealthy and making a lot of money. Picture two houses sitting side-by-side, one with a brand new Mustang sitting in the driveway and the other with a ten-year-old Escort. What can't we see? The answer is: their bank accounts. The person with the Escort may have a stock portfolio that you could not even fathom. In financial terms, his 'Net Worth' may be considerably higher than his neighbor. Nicer car aside, the person with the Escort may simply be worth more.

In the modern day, the best way to describe Net Worth is as a financial "selfie." It's a very clear snapshot of your financial status. Although it can change from one day to the next, it's your fingerprint, your fundamental image of what you look like financially on paper.

Your Net Worth consists of Assets (what you own), Debt (what you owe – whether it's short-term or long-term), and most importantly your cash flow. When it comes to your net worth, the key is to protect your assets, control your debt, and manage your cash flow. If you can achieve those three goals, your primary focus then becomes growth and compounding.

What does that really mean? We want to increase our assets; we want to manage the debt (which is critical) since it would have the tendency to increase as well (and that may not necessarily be a bad thing as long as it's managed well), and that's where the cash flow comes into play. Although they say "cash is king," in this scenario debt could be as big of a king as long as it's under complete management and complete control.

So, how do we figure out what our Net Worth is? We use something called a Net Worth statement. Every time you take out a loan you make a version of a Net Worth statement. If we've already listed out our debts and assets, we're already almost all the way there.

What we've been building up to here is figuring out what our net worth is. Now that you know what you have and what you owe, we can determine what our actual net worth is. Your net worth represents the level of wealth you have accumulated. To calculate this, you simply subtract your debts from the value of your assets.

ASSETS - LIABILITIES = NET WORTH

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If your debts are greater than the value of your assets, then your net worth has a negative value, and that means insolvency. Insolvency simply means that you are unable to pay what you owe, and it results from consuming more than you are able to financially (living outside your means) and can sometimes lead to bankruptcy.

Let's look at an example of a Net Worth Statement for someone who has been living on the outside for a while - Jacob, who was released five years ago:

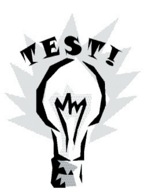
In our example, Jacob is doing fairly well. He's made some good decisions in investing his money. He may be upside-down on his car loan, but he has some good equity building in a nice house. Importantly, he is investing in a retirement account for his future. Jacob's Net Worth, after years of hard work is $21,132.

Is that good? What is a "good" level of net worth? That depends upon your goals and your place in the financial situation. You would expect a 45-year old to have a considerably higher net worth than a 25-year old, however, the answer does not necessarily rest on who has the larger net worth, but on who has done a better job of achieving their financial goals.

Net Worth Statement

Item/Description	**Value**	-	**Debt**	=	**Equity**
Real Estate	$125,000		$105,603		$19,397
Car	7,600		8,134		-534
Cash on Hand	600		0		600
Checking Account #1	1		0		1
Savings Account	5,800		0		5,800
Money Market Account	983		0		983
Mutual Fund	0		0		0
IRA	0		0		0
ROTH IRA	8,700		0		8,700
401k	0		0		0
Insurance Cash Value	0		0		0
Household Items	900		0		900
Jewelry	1,000		0		1,000
Personal Loan	0		0		0
Credit Card Debt	0		3,329		-3,329
Student Loan	0		4,386		-4,386
Medical Bills	0		8,000		-8,000
Total	$150,584	-	$129.452	=	$21,132

INSTRUCTOR TALKING POINT



What if we aren't doing quite as well as Jacob? What if we're actually facing insolvency? If your net worth is zero or even negative it is **NOT** the end of the world. As we mentioned, your net worth statement is your financial selfie, a snapshot in time. This means that it changes - every day. The important thing here is to make sure it changes in a positive way every time you look at it. We'll talk about how to pay off your debt in an organized, structured manner later on. But, let's assume that your Net Worth statement looks something more like this: [WRITE THE CHART ON THE NEXT PAGE ON THE BOARD]

INSTRUCTOR TALKING POINT

[Write the following chart on the board]:

Net Worth Statement			
Description	**Value**	**Debt**	**Equity**
3-year-old Ford F150	$20,000.00	($28,000.00)	($8,000.00)
Checking Account	$2,000.00		$2,000.00
Household Property	$500.00		$500.00
Credit Card Debt		($5,000.00)	($5,000.00)
Net Worth/(Loss)	$22,000.00	-$33,000.00	= ($10,500.00)

If this is your Net Worth today ($-10,500.00), and six-months from now you've begun to pay down your credit card debt and your Net Worth then works out to -$8,500. One year from now it's -$5,500. It's very easy to see that we're moving in the right direction and what your financial goals need to be. It will make you feel better about what you're accomplishing.

Eventually, that number will get down to zero and then go positive. Think of the feeling you'll have when you finally see that Net Worth go to a positive number. It will make you want to put even more away. It's not going to get there by itself; it's going to take discipline and financial maturity. You'll need to be able to follow everything we've talked about. It will take perspective and sacrifice.

Remember that your Net Worth statement is a financial snapshot. It describes your financial position at a given point in time. It is not a judgment or a description of you over a long period of time. In fact, your Net Worth statement today could be different from your Net Worth statement tomorrow, or even your statement in a few hours. It is a helpful place to begin to set our goals and put our plans into action.

You can find a blank Net Worth Statement in the appendix of this book to use on your own. The most important thing to take away from this chapter is to have the knowledge you need to make wise decisions, and then use that knowledge.

Your Net Worth should reflect your goals. Jacob may have goals for retirement, in which case he has a good start. He also, apparently, has some good knowledge of banking tools. How can we get to that point? We talked about some of the tricks of the grocery trade. Now, let's look at some of the tricks of the Banking world...

REEFS

Chapter 2 - Banking

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Now that you have the foundational block of budgeting in place, and have learned to measure your net worth and be a smart consumer, it's time to place the next foundational block; saving. When you think about saving, banks and other financial institutions come to mind. Saving is the part of income that you choose to set aside for purchases you wish to make in the future. Why should you save? Where should you save? How do you save? These are questions that will be answered in this chapter. We will examine the concept of interest and compound interest (for example, have you ever heard of the Rule of 72?).

We will also look at how safe it is to save in different ways. The goal is to keep your money safe, grow it, and still have access to it. Having a stash of cash under the T-shirts in the back of your top drawer or under your mattress is one approach, but banking offers a way to manage your day-to-day finances, provide safety, and increase your wealth.

INSTRUCTOR TALKING POINT

In this chapter we are going to start showing you some of the secrets of banking. We're going to pull back the veil of secrecy, so to speak, and show you: what actually goes on in the backrooms and boardrooms of a bank, what you can and can't do, and what the bank will and won't do for you. A bank is no more than your financial house; the better you treat it the better it makes you look. The better it makes you look, the more serious the world will take you. If you don't have a clean account at a financial institution no one will take you seriously.

Why is that? Any time you apply for a loan at the bank, they are more favorable toward people who do business with them. Remember that a bank is a business. They like it if you are their customer and show some loyalty to them. To put it another way, if your credit score is on the verge of being denied, having multiple accounts in good standing with the bank can be enough to push you over the edge and get you that loan. It's also more convenient to coordinate bank accounts that are kept at the same institution, but we'll talk more on that later.

Are banks your only option? In a word: no. Banks are the most common financial institution, but there are others. Credit Unions, in particular, are actually a much better value for you as a customer. Most people think they are interchangeable, but they are not. In this manual, we'll be referring mostly to banks for our examples because that's the sort of language most people are familiar with, but it's a much better idea to work with a Credit Union when you are first released from prison. There are several reasons for this, but the most important one is simply that money is cheaper there. Why is that? It's because they function differently from banks. Banks exist to make a profit. They pay out interest to use their customers' money in investment (for which they earn a higher return). Credit Unions, on the other hand, are non-profit associations for pooling the savings of members and making loans to them at a low interest rate.

INSTRUCTOR TALKING POINT

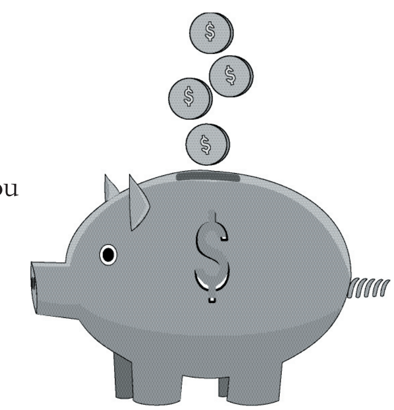
[USE INFO IN CHART OR JUST WRITE ON BOARD]

Institution	Pros	Cons
Commercial Bank – offer services like checking accounts, savings accounts, investment services, and loans	Usually have many convenient locations	Fees for checking and savings accounts can be high
	ATM and debit cards often available	
	Offer a wide range of services including different kinds of checking accounts, savings accounts, and loans	In a large institution, personal services many be minimal
	Deposits are insured by the FDIC	
Credit Unions – Non-profit institutions that provide banking services for their members	Often have the lowest banking fees and loan rates	Need to be certain they are federally insured
	Often have lower minimum account balance requirements	May not be conveniently located
	Offer several options for checking and savings	In small institutions, your options for products may be limited
	Small size sometimes allow personalized services	
	Earnings (in excess of expenses) are distributed to members	

Put simply: Credit Unions are not profit-focused. First secret: Using Credit Unions can give you a big advantage over using a bank. Although, we'll be referring to "banks" in the manual, all of the information can also be used at a Credit Union.

The two most popular banking products are a checking and savings account. We'll be talking about both in detail. As we go into the 21st century and convert into a digital era, most people are moving away from using checks to pay bills. It can all be done electronically, and most people now do. Most people don't even see paychecks anymore. They use direct deposit instead. We'll go into more detail about that later. For now, let's take a look at Savings.

Saving Money



New clothes, music, a car – these are all things we want and maybe even need, but if we spend without a plan, then all our money can disappear before we even realize it. Every time you spend money, you're deciding not to save it. What you spend today determines how much you have tomorrow.

We save money now so that we can spend it at a later time. We do this for three main purposes:

- To prepare for emergencies
- To purchase more expensive items that we cannot immediately afford (vacation, car, house, college)
- To provide money for retirement

The more we save now, the more we will be able to spend later. The **KPC**'s are just as important in saving as in budgeting. The saying to keep in mind is: "**Big Shot, No Shot**." What we think of as being a "big shot" is really no shot at all. We see flashy clothes and cars, and we think that is the definition of success; but why is it that so many famous football players and entertainers go broke? Just like when we talked about Net Worth, it isn't what you can see that necessarily makes you a success. What is success? How do we define it? Should we think about that and maybe redefine what we think it means to be a success?

We live in a society that prizes instant gratification above all other things. We want it, and we want it now. Remember those nibblers we talked about? How many people don't even operate with a budget? It's a lot more than you might think. So, we walk down a path that leads us to a financial trap, constantly living from hand-to-mouth. It's the impulse to spend so we can have what we want NOW that leads us to have gold teeth but no gas money, a pair of Red Monkey jeans and not be able to afford the rent, or a nice gold Rolex but have nothing to eat. The problem with celebrities who go broke (and with us when we follow their example) is that they don't control their finances, and so they lose power over them. That should seem strange because, with all that money, shouldn't celebrities be able to hire accountants to handle their finances? Yes, and they do. But, without a spending plan and a savings plan it really doesn't matter if you have a whole team of accountants. The one who has to exercise those **KPC**'s over your money is you.

We already talked about a spending plan in the last chapter. If you noticed, in each of our budget examples savings was a large percentage of our income. So, let's look at how to handle those savings.

Savings Accounts

What we need to do is fundamentally change how we think about money. Most people pay all their bills and expenses; and then save if anything is left over. If you do that, guaranteed you won't save much. What we're suggesting is that you consider your savings account as a very important bill. Just like with your rent or utilities or credit cards, you must pay it each month, on time and in full. Even if the amount seems small, say $10 to $20, you are building the discipline of saving. Pay *yourself* first!

As your savings account balance grows, it should give you a feeling of security, knowing that you have that money to fall back on in case of emergencies. Remember though, that saving is not investing. You put money in a savings account to meet those emergencies, save for a short-term need, something you intend to purchase in less than one year like a down payment on a car, or for something like a birthday present.

You invest to achieve middle to long-term goals (for continuing your education or putting money aside for retirement or a vacation, for example). The difference is time, and the risk tolerance that time gives you. To learn more about investing please take the Personal Investment Management class as it will go into this topic in much greater detail. Whatever your goals are, saving and investing both require a commitment to the future.

INSTRUCTOR TALKING POINT

But, why bother using a bank at all? There are check-cashing stores. There are prepaid credit cards. You could stuff your money in a sock or store it in a safe. There are plenty of options out there that will allow you to avoid using a bank altogether. What about those of us who can't get a bank account because of credit problems or past banking history? Banks do talk to each other, and a bad mark in one bank's records will follow you to other institutions.

There are options. Improving your credit score is not as impossible as it might seem, and we strongly encourage people to talk Credit & Debt Management to start doing that right away. Yes, you can even work on it from prison. As far as a bad banking record, many banks now offer "second chance" accounts. These can require high balances or direct deposit, but it is a very basic account that allows you to get your foot in the door and start rebuilding your reputation.

With the excuses off the table, the two major reasons to use a bank (or Credit Union) are safety and interest, and they go hand in hand because of a little thing called 'inflation.' Let's take a look...

Is it safe?

The only way to be 100% certain that your money is absolutely safe is to stuff it in a sock and hide it in a safe in your closet, right? Is it? What if you get burglarized? They're carting off ATM's now, it's far from impossible for a burglar with a hand truck to walk off with even the largest safe. What about if there's a fire? How "fire-proof" is that fire-proof safe? They are only rated up to a certain temperature, and even if the safe itself withstands the fire, money has been known to burn even inside the safe. What about a storm or a flood? Fire-proof safes are not also water-proof.

The biggest danger to your money in keeping it in a safe is inflation. It's a term we hear all the time, but what exactly is "inflation?" Is it "higher prices?" That's probably the answer that the government wants you to believe because it takes the responsibility off of them. Picture inflation like this:

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Theresa was a little girl living in Orlando, Florida. The year was 1948, and Orlando was a sleepy little town in the middle of a sleepy little state. The war was over, and the economy was doing great, but it still got very hot in the summertime in Orlando, and most of the people who couldn't afford summer homes up north spent the hottest months sitting on their porches in the shade.

Theresa liked to spend those summer months saving up to go to the movies. She could get into the double feature for a dime, and that included the cartoons! Her favorite radio shows were Abbot and Costello and Little Orphan Annie. Her dad made decent money as a real estate developer, but she didn't see him at home very much. She helped her mom with the washing and other chores around the house and received an allowance of five cents a month for it!

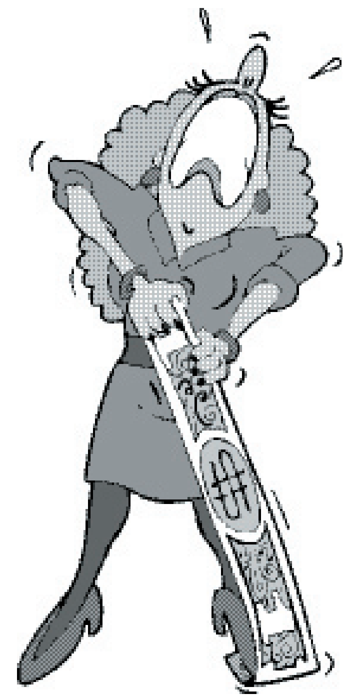
That September, Theresa decided that she wanted to save up for a movie and a candy bar as a special treat during the Christmas holidays. She already had the five cents for that month, so she took it and buried it in an old cookie tin in a special spot in the backyard to keep her from spending it before December rolled around. Theresa promptly forgot about the nickel.

2016. Theresa is now seventy-six years old, but still in great health. She's still living in Orlando, but it's now a bustling metropolis. It barely even resembles that sleepy town of her youth. With the arrival of air conditioning and Walt Disney, her sleepy little state turned into a tourist destination for the entire world. Most of the time that makes her smile. Sometimes, though, she longs for simpler times. Hardly anyone nowadays even remembers who Bob Hope was, and a movie today costs 16,000% more than it did back in the day. More, really. It's $16 for a ticket with the tax, and that only includes one *movie and NO cartoons.*

When she hears that the house she grew up in is being torn down to make way for a new shopping center, she asks the developer if she can visit the property before they begin. The developer, who happens to be the grandson of her father's lead contractor, agrees, as she's an old family friend. As Theresa wanders around the backyard, she notices an old rusty cookie tin sticking up out of the ground near a tree.

Suddenly, she's transported 68 years back in time to that late September when she started saving for a Christmas treat. With a smile, she digs up the tin and opens it to see her nickel, still safely nestled inside. On a whim, she decides to treat herself to that candy bar that she wanted so very long ago. At the store, she hands over the five cents for a Hershey's bar, plus another $1.95.

Why did the price go up so much? Inflation is not the change from a five-cent candy bar to a $2.00 candy bar. Inflation is all the extra money that's now floating around compared to what there was back in 1948. A lot of new money has been minted in the past 68 years to account for changing prices as well as a rapidly increasing population. Think about it, if the population increases by 12 million people, but there's still the same amount of money, there won't be enough to go around. So… we print more! Unfortunately, that means that the value of that money goes down. And, that's inflation.



What does this have to do with keeping my money safe? Just like with Theresa, if you keep your money in a safe in the closet, it loses value over time. Now, you might not be keeping it there for 68 years, but even if you only keep it there for a year or two, it's no longer worth quite as much as when you put it in the safe. Try as you might, that dollar just won't stretch as far as it did when you stored it.

So, what IS the only 100% certain way to keep your money safe from things like fire, theft, flood, or inflation? Put it in the bank, right? Banks, Credit Unions, and other financial institutions are insured by government agencies, after all, like the Federal Deposit Insurance Corporation (FDIC) and the National Credit Union Administration (NCUA). What those agencies say is that the U.S. government will replace your money (up to $250,000) in case the bank or credit union is robbed, flooded, or burned to the ground. Perfect, right?

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Actually, there is no 100% certain way to keep your money safe. The FDIC and NCUA are backed by the full faith of the United States government, which is a pretty strong safeguard, but what happens if the economy suffers a downturn? What happens if the economy crashes? The riskier your financial portfolio is, the more susceptible it is to economic fluctuation. Sounds fancy, but what it means is that stocks are going to be the biggest risk if something happens like a stock market crash. Savings are going to be among the most stable places to have your money, but if the crash is bad enough it could cause the FDIC to lower its guaranteed limit. If they decide they can only guarantee bank funds up to $100,000 and you have $175,000 in there, guess what happens.

So, as with most things in life there aren't any absolute guarantees. That said… a bank or credit union is still a much safer bet than storing the money yourself. It also provides you with a cushion against inflation, something that you can't do by keeping your money under the mattress. That cushion is called *interest*.

Interest is one of the best reasons to consider using a financial institution. The reason is because of what banks (or credit unions) do. Banks are businesses. They exist, like every business, to make money – lots of money. They do that in a number of ways. One is by charging fees to their customers. The other is by taking money that is given to them for safekeeping and using that to invest for a profit. All that money that the bank loans you to buy a car or a house with has to come from somewhere, and that's where all those savings accounts come into play.

According to the Council for Economic Education, Standards for Financial Literacy, "an interest rate is the price a financial institution pays for using a saver's money and is normally expressed as an annual percentage rate (**APR**) of the amount saved." In other words, interest is the amount of money a bank pays to a customer annually in exchange for the right to use the money that the customer deposits in the bank. It also works the other way – interest is also the amount of money a bank charges you when *you* borrow money from *them* in the form of a loan. Interest rates paid on savings accounts are always lower than interest rates charged on loans. Remember, banks are in business to make a profit. Therefore, if the average interest rate on a home loan is 6.5%, a bank may pay 1% or less on a savings account (a good rate as of 2016 is somewhere around 0.6%). Before you choose a bank, check the interest rates they pay on your money and fees that they may charge. As with everything, comparison shop.

INSTRUCTOR TALKING POINT

Savings accounts, although mainly used to save money, can be a very practical tool to build a strong net worth. This can be very helpful when the time comes and you would like to buy a house by securing a mortgage at some point in the future. Your savings account demonstrates your ability to be responsible and disciplined by showing the initiative to save enough money to put a sufficient percentage of money down on the home you want to buy.

But, savings accounts are never going to provide a great return for your money. Bear in mind that a savings account is more about discipline to achieve short-term goals or emergencies. You want that money there to fall back on. How much should you save? Ideally, we mentioned the figure of 10-20% in the first chapter, but part of that should also go toward investment and retirement planning. Where do you draw that investment money from? Ideally, you could lower your discretionary income for it. If you don't have much discretionary money (as in our first Taco Bell job example) you could lower savings amount. Again, in our Taco Bell example, we had put more than 16% of our income into savings. That's good, but you could also lower that to 10% and invest the other 6%. Either way, you are growing your money. You need that money in savings for ease of access in an emergency, but investment will get you a much higher return.

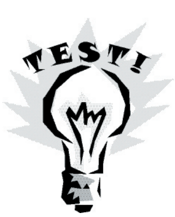
However you decide to do it, the point is that it needs to be done. Paying yourself first is about putting money away for your own safety and future. The bare minimum you should be saving is 5% of your income, but 10% is a much better figure. We'll talk more about investment in a later chapter. And, even with a basic savings account, you will be building some interest. And, that's the key. The trick to savings is to make your money earn money. Remember our first money saver tip on page 4 – "When your money starts earning money, your then begin to build WEALTH!"

Job #1		
$8.25 per hour		
40 hrs/ Weekly Income		$330.00
(times 4.33)		
Monthly Income		$1,428.90
Less Withholding 15%		($214.34)
Net Pay $1,214.56		
SNAP assistance: $194		
Expenses:		
41.2%	Rent	($500)
6.7%	Food	($81)
8.2%	Clothing	($100)
16.5%	Savings	($200)
10.3%	Utilities	($125)
6.6%	Probation	($80)
3.3%	Transport	($40)
7.2%	Discretionary	($88.56)
100%	Total	($1,214.56)

All interest is not the same

Suppose you invest $10,000 into a savings account that pays 0.6% interest. At the end of the year, you will increase your bank account by $60 ($10,000.00 x .006 = $60). Now, you have $10,060 in your account. In the second year, the bank will now pay interest on $10,060 ($10,060.00 x .006 = $60.36). Now, you have $10,120.36 in your account. This is called **Compound Interest**, and it works faster because it pays interest on the interest from the previous year.

Building up Interest		
Deposit $10,000 at 0.6% APY		
	Interest earned	**Total Amount**
1 year	$60.00	$10,060.00
2 years	$120.36	$10,120.36
5 years	$303.62	$10,303.62
10 years	$616.46	$10,616.46
20 years	$1,270.93	$11,270.93
30 years	$1,965.74	$11,965.74



Simple interest also exists, but it is increasingly rare in today's market. In **Simple Interest**, you only receive interest on the principal that you deposited. So, you would only be receiving interest on the initial $10,000 in our example every year ($60 per year). This is so uncommon in today's market that it's barely worth mentioning. But, you do need to pay attention. If you find a bank offering a savings account with simple interest, find another bank. Most institutions will offer Compound interest (which pays interest on the principal and accumulated interest).

What you should pay more attention to is the Frequency of Compounding. The more frequent the compounding, the better. Daily is better than weekly, weekly is better than monthly, monthly is better than quarterly, and quarterly is better than annually… and so on. Most savings accounts will offer quarterly compounding, but if you can find one with quarterly compounding grab it. Put simply, savings accounts with compound interest equals more money for you.

INSTRUCTOR TALKING POINT

Simple interest plans are out there, but you should never use them. There are just too many options using compound interest. The key to worry about then is the frequency of compounding.

Interest on savings accounts and CD's are not high, to say the least. Inflation is typically around 3% per year. The Federal Lending Rate floats around 3.5%. Banks are going to give you a much worse interest rate for savings or CD's. Again, this is more for emergencies than for long-term growth. But, all savings instruments are not created equal, either. When you get ready to open an account, you'll see a lot of figures. By comparing different institutions' interest rates, you will see something like this for 5-year CD's:

Bank A	Bank B	Bank C	Bank D
2.5% interest	2.5% interest	2.5% interest	2.5% interest
Compounding weekly	Compounding monthly	Compounding quarterly	Compounding annually (called Simple Interest)

If you deposited $1,000 in a CD account in each of these banks, here would be the balance of the account at the end of the year:

Bank A	Bank B	Bank C	Bank D
$1,025.31	$1,025.29	$1,025.24	$1,025.00

Weekly compounding is better than monthly, which is better than quarterly, which is better than annually. With nearly all savings accounts, you will lose purchasing power over time because of the rate of inflation. But, you should minimize the loss of that purchasing power. The difference here is not dramatic, obviously, but would you rather have 31 free cents or 0 free cents? Remember that it all adds up over time.

Fair warning: The vast majority of savings accounts and CD's compound quarterly, but if you can find a more frequently compounding account take advantage of it.

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The Rule of 72

This is a rule for quickly figuring out the growth of your savings or investments using compound interest. Seventy-two divided by the interest rate will tell you how many years it will take for your money to double. So, in our example of 0.6% interest, you would divide 72/0.6 and it would take 120 years to double your money.

Now, that seems like a long time, and it is. With the same interest rate, Theresa's nickel would not even have turned into a dime in the same time it was buried in the ground. Remember, though, that savings accounts are not true investments. They are tools to help you achieve short-term goals (birthday presents, emergencies, etc…). It's your safety net. But, why not get paid for storing it? Even if your goals will be reached in five years, you just earned $303.62 in our example. That's in exchange for doing nothing more than keeping your money in the bank.

Real investment involves much more risk but a much higher rate of return. As a quick example: One of the most popular industries in stocks is the tech industry (streaming data, in particular), and one of the most popular companies in recent years is a little outfit called Netflix. In February of 2015, the stock price of Netflix was around $151; by October of 2015, it was at $763. That's an increase of $612 or 405.3%. If we invested $604 in 4 Netflix shares in February, by October our investment would be worth $3,052.01. What if we invested $10,000 in Netflix (the same amount that we were putting into our savings account)? In those six months, our investment would be worth $50,530. In other words, using the rule of 72, our money doubled about every two months or so.

But, remember the **K.P.C**.'S here, meaning 'understand risk management.' To put it in gambling terms, "you've got to know when to hold 'em, know when to fold 'em, know when to walk away, and know when to run." To do this you need the **Knowledge** (research the history of the stock), **Power** (have the ability to buy the stock), and **Control** (have the willpower to wait before pulling your money out too soon). Make no mistake; the risks of the stock market are very real. If we had invested in Radio Shack back in 2012, we would have paid $11.10 per share. That would have given us 900 shares for our $10,000. Two years later, Radio Shack had dropped to 80 cents per share. That's a 93% drop. Our $10,000 investment would now only be worth $720. Again, Personal Investment Management will go into much greater detail about how to do all the research, what it means, and what the risks are. It's definitely worth it for longer term investments. However, it takes a lot of time and effort, but the rate of return with stock investments is a LOT higher than what you can get with a savings account.

Is there anything in between high risk investments like stocks and playing it completely safe by using a savings account? Absolutely. One example is a Certificate of Deposit (or CD). You can purchase a 60-month CD paying around 1.75% per year at a fixed rate. So, for the same 5 year period, if you invested your $10,000 in a CD it would be worth $10,906.17. That's an extra $602.55.

The big difference in interest rates is time. Banks are willing to pay you more if they are allowed to use your money for a longer period of time (and thus make more money for themselves). The longer the investment period, the better your interest rate will be. Time also works for you in gaining that interest. In other words, start as early as you can for the best return. We'll go into more detail in long-term savings for things like retirement in a later chapter.

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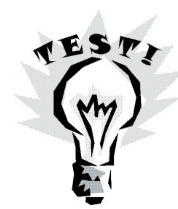
Types of Savings Accounts

Regular Savings Accounts

The most traditional way to save money in a bank is with a basic savings account. Even here, banks will offer different types of accounts. Things to look out for are those minimum opening deposits and minimum balances and any monthly service fees. This type of account:

- Pays monthly interest
- May require a minimum deposit
- May have limits on withdrawals
- Pays very low interest rates

Certificate of Deposit (CD):



Basically, a CD is a contract between you and the bank. It's like the mortgage loan they give you to buy a house only in reverse. In this case, you are agreeing to loan money to the bank and giving them a fixed period of time (2 years, 5 years, 10 years, etc…) to pay it back. If you demand the money back early, it costs you money.

- Money must remain in the account for a term or fixed period of time
- The more money you deposit and the longer you keep it in the account, the more interest you earn
- You pay a penalty if you withdraw the money before the term is over

INSTRUCTOR TALKING POINT

A Certificate of Deposit is a contract between you and the bank. Think of it as a loan in reverse. Instead of you signing a mortgage for a loan from the bank, the bank is signing a Certificate of Deposit for a loan from you. You have agreed to keep your money in the bank for a certain period of time, which allows the bank to take that money that they know they can use for that period of time and loan that money out. The bank is expecting to collect the money that they loaned out back with interest, so when it comes time to pay you back they will have the funds available to do that (and, with a bank they will actually be making a considerable profit). If you break this contract and you need your money back early, you have upset their cycle of receivables and payables. The bank will then penalize you by requiring you to pay at least a full month's interest for your early withdrawal.

You can purchase CD's in any terms from 3-months up to 5-years (depending on what is offered at the bank. The thing to remember is to make sure you can leave the money in the bank for that amount of time. CD's are among the safest investments next to savings accounts. The risk here is the time factor that you have agreed to, as you won't have access to your money for that period. As such, they offer a higher return on your money than with a savings account, but it's still typically lower than the average rate of inflation.

Money Market Accounts:

These types of accounts are a kind of hybrid between a checking account and a savings account. They require higher balances and higher fees, but the bank makes up for it by offering a higher interest rate.

- Savings accounts that let you write a limited amount of checks
- Limits on withdrawals
- Higher interest rates than a regular savings account

As an example, here is a chart showing the savings accounts offered by Wells Fargo as of December of 2016:

	Way2Save Savings Account	Opportunity Savings Account	Platinum Savings Account	Time Accounts (CD's)	Way2Save Retirement Account
You prefer:	Designed to make saving on a regular basis easy. Offers three automatic transfer options; combine options to save even more.	An affordable basic savings account for customers not meeting regular Wells Fargo account opening standards	Variable-rate savings account offering premium interest rates, available exclusively to Wells Fargo checking customers	A guaranteed fixed interest rate with tiered rates and a choice of terms.	Makes it easy to take the first step toward saving for retirement. Conveniently grow your retirement savings with automatic transfers from your Wells Fargo deposit account.
Minimum opening deposit:	$25	$25	$25	$2,500 ($1,000 for IRA)	$100
Monthly service fee:	$5	$5	$10	None	None
Avoid the monthly service fee:	When you have one of the following each fee period: •Minimum daily balance of $300, or •Choose one automatic savings option –Save As You Go transfer –Daily automatic transfer of $1 or more from your checking account –Monthly automatic transfer of $25 or more from your checking account –Primary account owner is under the age of 18	When you have one of the following each fee period: •Minimum daily balance of $300, or •Monthly automatic transfer of $25 or more from your Opportunity Checking account	When you have a minimum daily balance of $3,500	Not Applicable	Not Applicable
Source of overdraft protection	✓	✓	✓		
Limited Check writing			✓		

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Money Saver! A savings account is a good place to put money you might use within one year. A CD is a good place to put money you might use in 1-3 years. <u>Money you can put away for longer than 3 years should be considered for investing.</u>

Checking Accounts

Most people open a checking account simply for the purpose of paying bills, and yes there are other options for that in the age of Smartphones. There are virtual payments, peer-to-peer payments; digital transfers… entire virtual banks even exist. But, the traditional checking account is still the most common way for people to pay bills. Modern checking accounts combine the convenience of online banking and real-world transactions in new and exciting ways. We'll discuss online banking in more detail later. For now, we are going to learn to use a checking account as a tool to help budget and efficiently handle your money management.

There are a number of vital reasons for you to have a checking account. You use one as a place to put your income and from which to pay your bills. If a savings account is safer than storing your money in a safe at home, then a checking account is even safer because checks let you carry around money without carrying around cash while still earning interest. If a check is lost or stolen you can call the bank and place a stop payment on the check. By comparison, if your cash is stolen there's not much you can do. A checking account helps you keep records of how you use your money by tracking each individual transaction. Finally, a checking account is an inexpensive way to pay bills. Yes, you can also use a check cashing store and pay your bills using cash or money orders, but that is a very expensive alternative and does not help you build wealth. We'll talk more on those alternatives later.

INSTRUCTOR TALKING POINT

Checking accounts are convenient. They are easy, and they're getting easier all the time with the rising popularity of online and virtual banking. Your checking account is your greatest tool to track and manage all of your bills. Not only does it ensure that all of your bills are paid, it also creates a financial 'footprint' exhibiting how and when your money gets spent. It's a very convenient task as long as you don't abuse it, and you're aware of the dangers. The key here is to never overdraw your checking account into a negative balance. Beware of fees. As always, read the fine print when you sign any contract to open an account.

The only problem with having a checking account is the cost: monthly account fees, check ordering fees, and insufficient fund fees. Fees are a large part of how a bank makes their money. They may seem small on their own, but they add up. Banks will generally try to inundate you with multiple offers and small print to lure you into signing up for the most expensive accounts, but remember the **KPC**'s again. Problems with fees are easy to resolve with a little common sense and Knowledge. Most banks will waive the monthly fee, and check ordering fee, if you use direct deposit. Most employers even receive an incentive from the bank for setting up automatic payroll deposit, so everybody wins. Nearly all employers offer direct deposit today, and some will *only* pay you with direct deposit. Use it and the first two fees are off the table – that was easy.

INSTRUCTOR TALKING POINT

What is direct deposit? Direct deposit is where you do not receive a paycheck on payday from your employer. What you get is a check stub usually attached to a check that says void against it. Your employer must show you every deduction that is taken out of your paycheck. There are a lot of advantages to direct deposit other than just the savings that you get by using direct deposit with the bank.

- You do not have to wait on your paycheck;
- You will have access to your money at 12:01 am on payday;
- You can't lose the paycheck on the way to the bank; and
- You won't have to wait in line at the bank waiting to get your check cashed.

Direct deposit is a fact of life now. Many employers will *only* pay their employees with direct deposit now. It saves them time, money, and headaches. There is, essentially, no downside for them. It's also a huge plus for the banks. They are guaranteed that money will be deposited in their institution when you use it. For you, there can be *some* disadvantages, but they are few and mostly stem from not having a bank account to begin with. Most banks will even allow you to forgo the initial deposit to open an account if you sign up for direct deposit with a current paycheck. The benefits here are enormous.

As we look at the chart on the next page, notice that almost ALL of the monthly fees with checking accounts can be waived simply by having direct deposit. This is step one to doing away with all those fees.

The last fee, insufficient funds (bounced checks) are a little bit harder to solve, but that's why budgeting is a foundational block. If you are living within your means, then your checking account becomes a useful financial tool. If you are living beyond your means, then a checking account is going to get expensive. If your decision at this point in your life is to live within your means, and to build wealth, then you must use a checking account.

INSTRUCTOR TALKING POINT

Fees are a major source of revenue for banks. It may not seem like it since the fees that you pay are only $15 per month (or $5 or $35) or so, but if your bank has 3 million customers and half of them pay that $15 per month, that equals 22.5 million dollars. Consequently, banks will apply as many fees to you as they can. For instance, did you know that some banks will charge you a fee for doing nothing? If you fail to initiate any transactions in your account for a certain period of time might get you hit with an "inactivity" or "dormant account" fee of $5 to $15 until you do. Continued inaction could cause the bank to freeze your account. If you then wrote checks off the frozen account, those checks would bounce, triggering NSF fees. SunTrust, for example, charges $15 per month after 12 months of inactivity. Commerce Bank charges $3 per month after only 60 days of inactivity. It's important to find out exactly what fees your bank charges and how they might apply to you.

INSTRUCTOR TALKING POINT

Why not just hold a Checking Account, then? If they are so useful and Savings Accounts bear such a small amount of interest, why bother with the savings account at all? Wouldn't it be easier to just put my money in a Checking account and not have to worry about it?

The problem here is, again, interest. Few Checking accounts yield any interest at all. Those that do typically have high minimum balances (see the PMA and Preferred Checking Accounts in the chart below). Remember that our goal is to make our money grow. Even though a Savings account doesn't yield much interest, some is better than none. Additionally, holding multiple accounts at the same institution increases your borrowing clout at that institution. In other words, if they know you as a good customer they will want to keep you as a customer.

It may seem like a lot of bother to maintain two accounts, but, realistically, it is very easy to link a savings and checking account. It's even easier with an online account that allows you to transfer funds between them at any time with a swipe on your smartphone.

One of the keys here is to use both a savings and checking account and hold them both at the same bank or credit union. This allows you to keep the balance of your money in a savings account where it will earn interest (most Checking Accounts do not). You keep only enough money to pay your monthly bills and expenses in your checking account so your savings account can keep building as much interest as possible.

Checking accounts come in different varieties and the one you choose should fit your needs. If you are going to write a lot of checks each month, say fifteen plus, you are going to need to keep a larger balance of money in your account. A free checking account would be a good choice. As long as you keep a minimum balance in your account there are usually no monthly fees. Monthly fees may kick in (ranging from $5 to $30) if your balance drops below the minimum amount. If you are not going to write many checks each month you probably don't need to keep a large balance. For you, the best choice may be a budget checking account. Budget checking accounts charge a small monthly fee, and you pay a small fee for each check you write (usually around 25 cents). In all cases, the bank will automatically take your monthly fees from the balance in your account.

INSTRUCTOR TALKING POINT

Online checking is even easier. In the example on the next page, they offer a Checking account that waives the monthly fees for simply forgoing paper account statements. Most banks offer some incentives for banking online-only. The checking account in the example is set up for teens, of course, and is very basic, but it's worth asking what sort of incentive programs a bank offers for this type of service.

The point here is to do everything possible to minimize the fees you face from doing your regular banking. Believe it or not, *fees* are where most banks see a large portion of their profits (and it is one other reason why Credit Unions can be a better alternative - they generally charge lower fees for their services). A $10 per month fee to hold a checking account may not sound like much, but if you multiply that fee by a million customers (which is conservative for a bank like Wells Fargo), their company just made $10,000,000 for doing almost nothing.

We'll talk more about some specific fees later, but keep this in mind while you look over the charts on these few pages: **What will this account cost *me*?**

Using our Wells Fargo example, these are the different types of Checking accounts they offer as of December of 2016:

	PMA Package	Preferred Checking	Everyday Checking	Opportunity Checking	Teen Checking
You prefer:	Premier checking package that offers meaningful benefits, competitive rates, and discounts	An account designed for customers with higher balances or a Wells Fargo Mortgage	An account to meet your everyday financial needs	Specially deseigned for customers who have been unable to open a checking account due to their prior credit or banking history	Smart way to help teens learn real-world money management skills
Monthly Service fee:	$30	$15	$10	$10	$3
Minimum opening deposit:	$25	$25	$25	$25	$25
Avoid the monthly service fee:	When you have one of the following PMA statement ending balances: •$25,000 or more in qualifying linked FDIC-Insured accounts, or •$50,000 or more in qualifying linked bank, brokerage, and credit balances (including 10% of mortgage balances, certain mortgages not eligible).	When you have one of the following each fee period: •$10,000 or more in combined minimum daily deposit balances, or •Qualifying direct deposits totaling $1,000 or more, or •A linked Wells Fargo Home Mortgage	When you have one of the following each fee period: •$1,500 minimum daily balance, or •Qualifying direct deposits totaling $500 or more, or •10 posted debit card purchases/payments from this checking account, or •Linked to a Wells Fargo Campus ATM or Campus Debit Card	When you have one of the following each fee period: •$1,500 minimum daily balance, or •Qualifying direct deposits totaling $500 or more, or •10 posted debit card purchases/payments from this checking account	When you have online-only statement delivery
Monthly service fee discounts available:			$5 monthly service fee discount when the primary account holder is 17-24 years old		
Free access to Online Banking with Bill Pay	✓	✓	✓	✓	✓
Interest-earning checking account	✓	✓			
Free or discounted checks	✓	✓			
Bonus interest rate on select savings accounts	✓				
Brokerage benefits	✓				
Waived Wells Fargo ATM access fees at non-Wells Fargo ATM's	•Limit 2 per fee period (combined U.S. and International), or •Unlimited (U.S. and International) if you have $25,000 or more in qualifying PMA relationship balances	•Limit 1 per fee period (U.S. only)			

To open a checking account you will need to complete a few forms and provide the bank with two kinds of valid identification, at least one of the identifications will need to have your photo (driver's license, state ID card, passport, etc…). Virtual banks and some brick-and-mortar banks will also allow you to open a bank account online. It's faster and certainly more convenient. They will ask security questions to verify your identification and have you fill out the necessary forms digitally. The bank will also require a record of your signature so you will be asked to sign a signature card. Signature cards are used to make sure that your paper checks are actually signed by you. Therefore, it's important that you decide in advance if your name will be the only one on the checking account. If you are married, you may want a joint checking account. A joint account allows both owners of the account to write checks and sign their respective names.

INSTRUCTOR TALKING POINT

Once again, there are large advantages to online banking. There are reasons for its popularity, and most of them stem from its convenience. Opening a virtual account involves answering security questions. They will ask for some verifying information such as your Social Security Number. It's a much faster process.

That doesn't mean that it carries no dangers. Everyone should be aware of the prevalence of identity theft. It is the number one crime in America. Always be aware of what information you are sending over the internet. One piece of advice is: do *not* open a banking account over public access wi-fi. Use a secure connection and a secure password. Beware of shady websites that may masquerade as financial institutions. Use a verifiable bank or credit union and make certain that is their true website. Remember that convenience does not mean that you don't have to take responsibility for your security and safety.

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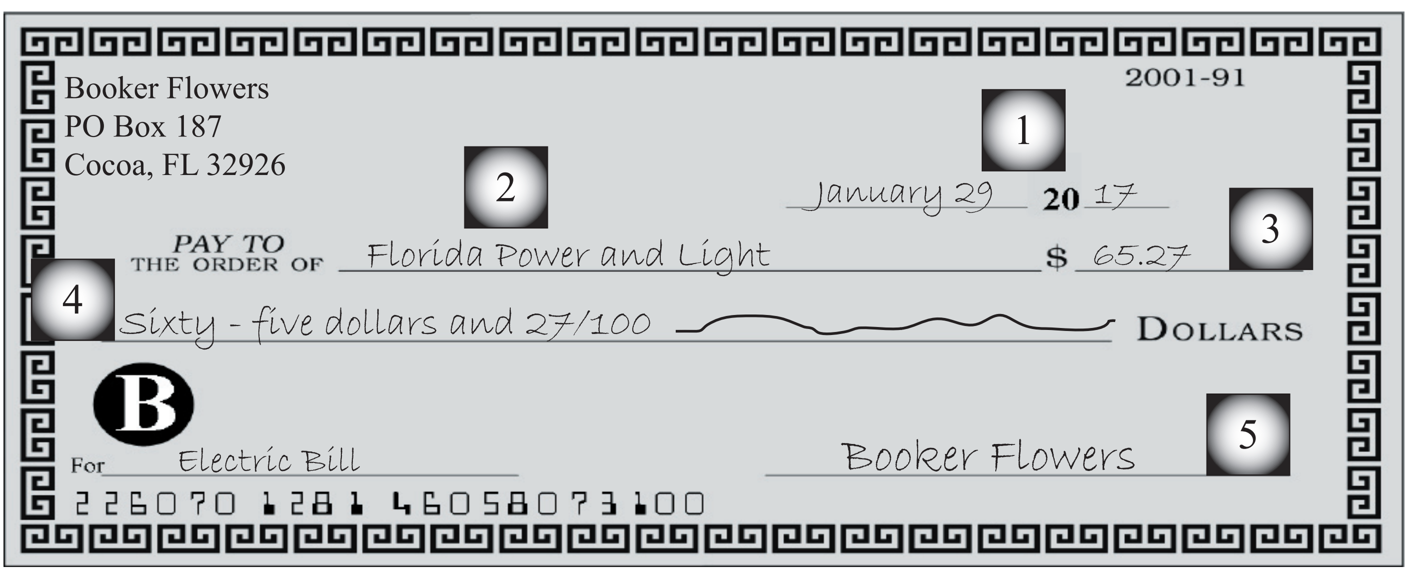
When you first open your checking account the bank will give you a set of temporary checks and deposit slips (or send them to you). Within a week to ten days you will also receive a new box of checks and deposit slips printed in your name that will contain your account number and address. Depending on the type of checking account you choose, the checks may be an extra cost.

Do physical checks still exist in the age of online banking? Check-writing may be dying, but it isn't dead yet. In the age of payment apps and chip cards it's becoming less common, and writing checks is gradually becoming passé. It's slow (about 67 seconds for a check versus 20 seconds for a debit card transaction), and it requires more work. In some circles, pulling out a checkbook at the coffee shop counter is viewed as kindly as the little old lady in front of you pulling out a pile of expired coupons and her change purse when you're in a hurry. Many younger people don't even know how to write a check or realize that you can use them in stores. But, people do still use checks. A lot of people. In 2015, Americans wrote 17.3 billion checks (according to a survey by the Federal Reserve). That's about 52 checks for every American. That's 24.6 billion less than in 2000, but you may still need to write the occasional paper check.

Writing a Check

Let's take a closer look at how you actually write a check. In our example, Booker writes a check to Florida Power and Light to pay his monthly electric bill of $65.27.



1. The date can be written in numbers or words: January 29, 2017 or 1/29/17
2. Pay to the order of is written in as Florida Power and Light (Do not abbreviate)

INSTRUCTOR TALKING POINT

Can I write the check out to FPL? Would the Florida Power & Light accept the check and would my bank cash the check? They absolutely would....but the bank would also cash the check for someone named --- Frank Paul Lennon--- It's very important to write the check to the exact person or company you are paying. Online banking can eliminate this worry, but it brings its own problems - namely: typos. When entering a payment, the bank will ask for the account number of the person or company you are paying. If you are paying Florida Power & Light Account #6179635628, but you enter in account #6179635622, the wrong person may be payed. Always be careful of the information you are entering or writing for payments, regardless of what method you use.

What would happen if I wrote the amount in numbers as 65.27 and on the next line wrote Sixty-seven dollars and 27/100 --- would FP&L accept the check and would the bank cash the check and for how much? The bank uses the line that you wrote out in long-hand. What would happen if you only had $65.27 in your account? Your account would overdraw! You would get hit with a $35.00 overdraft fee from your bank and probably a $25.00 fee from FP&L. Can this happen online? All it takes is for you to enter the wrong amount for payment. Pay close attention whenever you are making or setting up payements.

3. The amount of money is first written numerically: $65.27. Use a decimal point to separate dollars and cents.
4. On the next line, use words to write the same amount of money. Start writing the amount at the beginning of the line. Write the dollar amount in words. Then write "and". Write the cents as a fraction of a dollar, such as 27/100. Draw a wavy line across the empty space on this line. You draw the wavy line so that no one can change the amount on the check. Here's an interesting note: if the dollar amount you have written in numerical form is different than the dollar amount you have written in words, the written dollar amount in words is the one that will be honored by the bank.
5. Sign your name as it is on your signature card.

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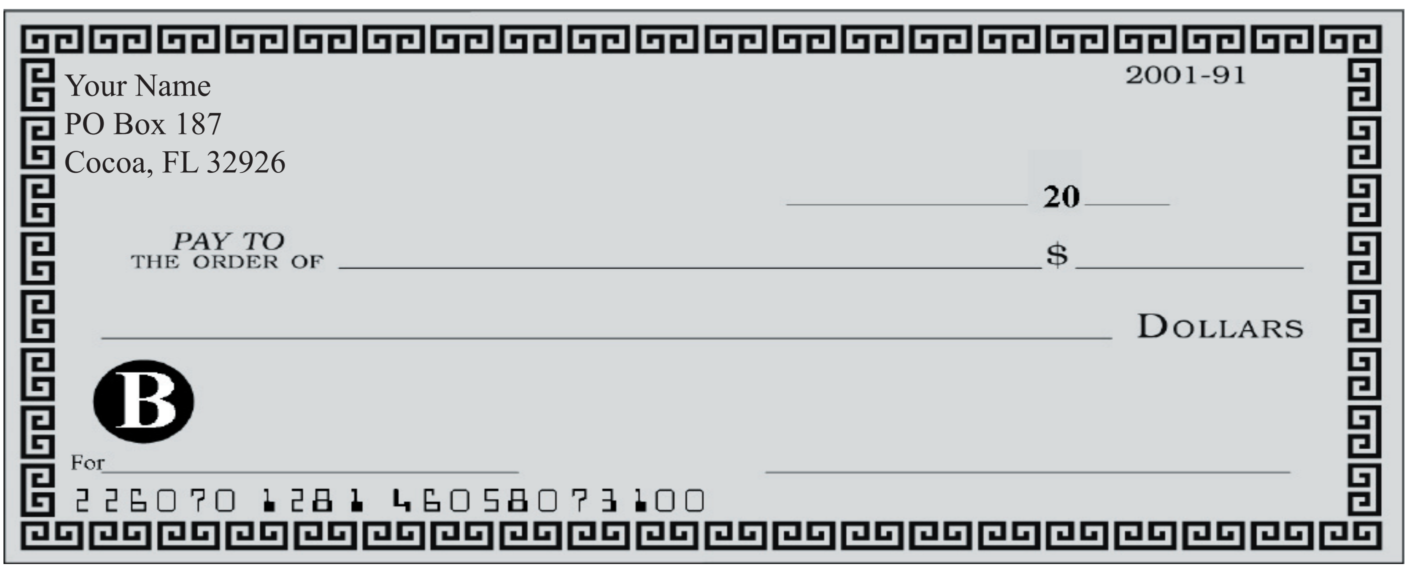
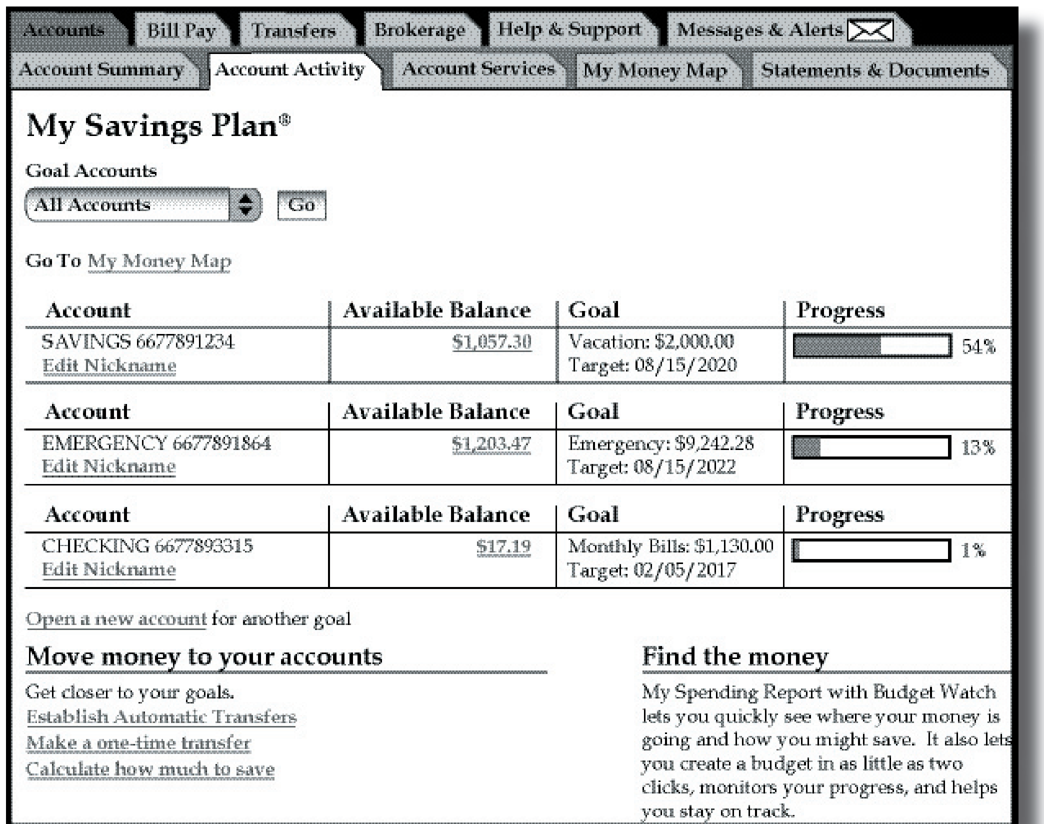
Try an example on your own. Fill out the following check using this information: You are writing a check to Capital One on March 29, 2017 in the amount of $48.92.



Online Banking

Often grouped with Mobile Banking, online banking offers a lot more convenience for the consumer. It also limits costs for the bank, so many of them will waive fees or offer lower balance requirements if you choose to receive online statements and use only a limited number of physical checks. Many banks will also offer debit cards linked to your Checking Account so that you don't have to issue as many checks (virtual or physical). Be careful with these cards. A debit card is fine, but you should never use a Debit card as a Credit card. It can cost you a LOT of money. Credit and Debt Management class goes into this in much more detail, but for our purposes, simply be wary.

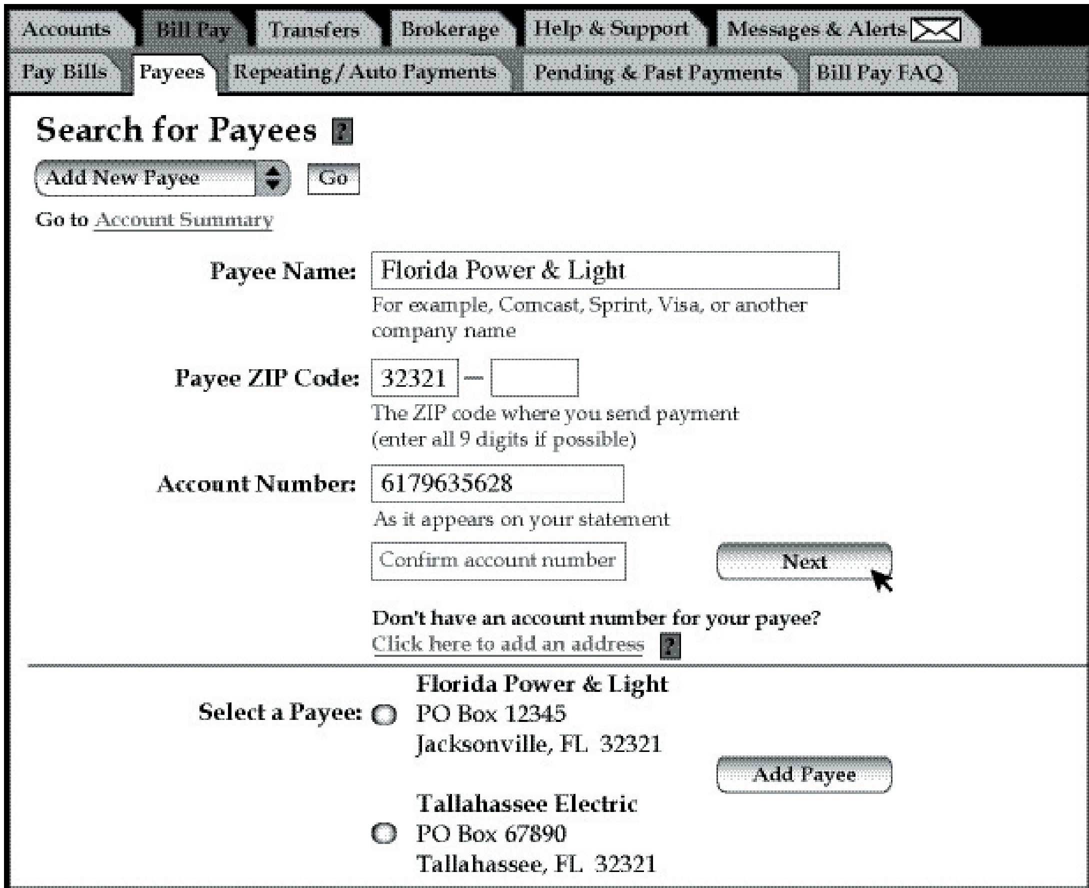
Online accounts look much like the following (keep in mind that there will be differences between institutions):

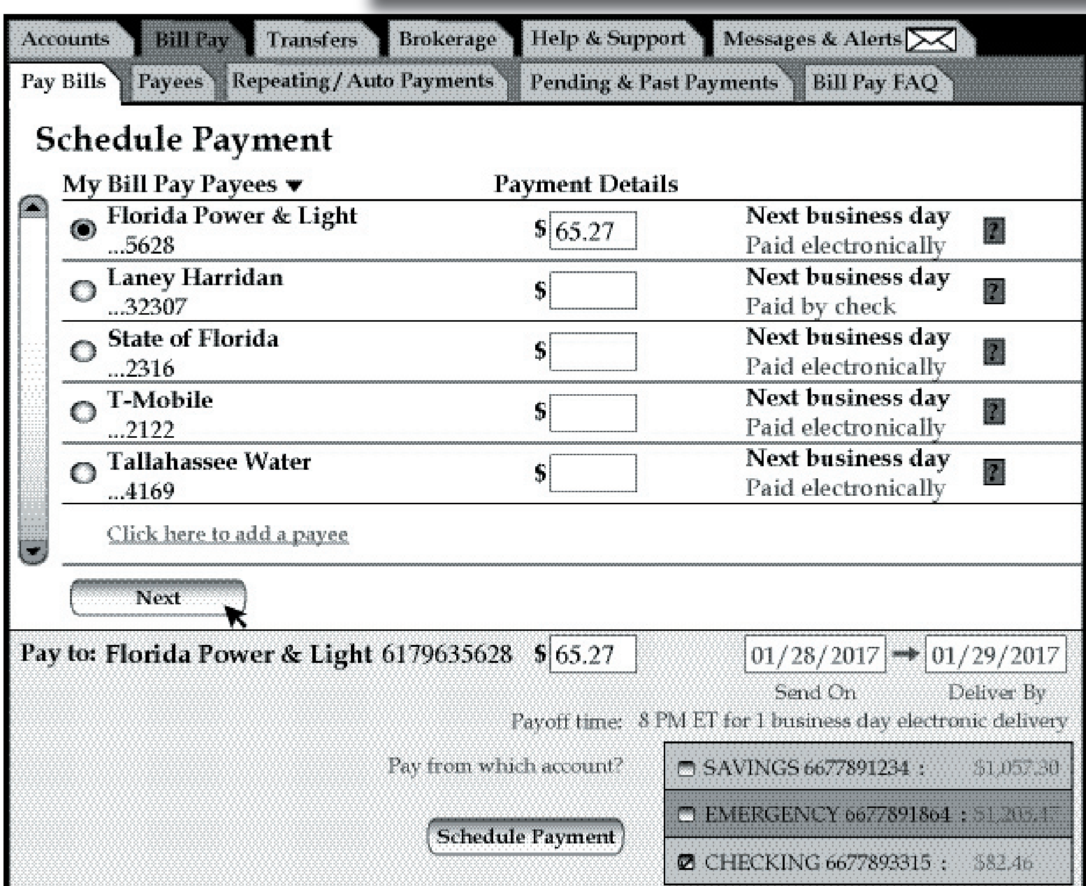


There are tabs for an account summary, automatic bill pay, money transfers, messages and alerts from the bank, and so on.

Issuing an online payment functions a little differently from writing a paper check. There are a few more steps, but it's faster and easier even with those steps because you can set up a payment one time and make those payments automatic that you need to send out regularly. Let's look at how this works with online banking:

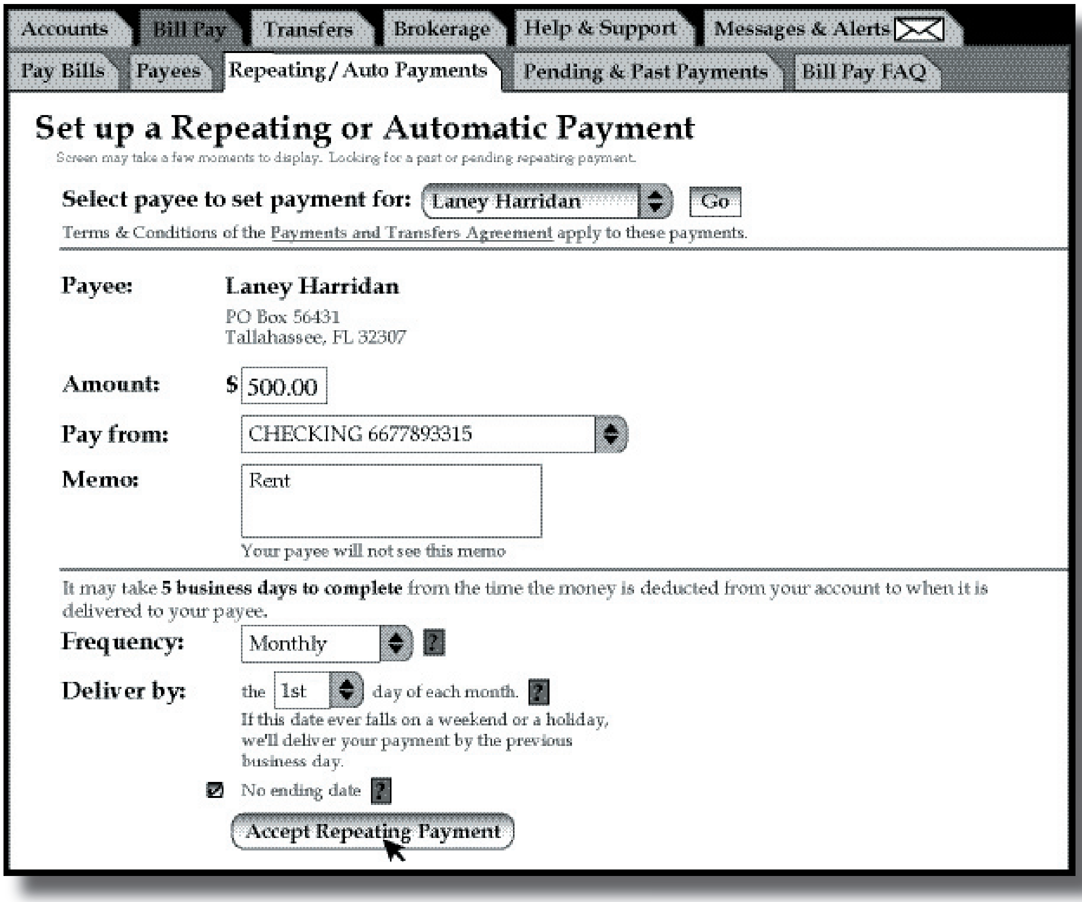
Step One: set up a payee in your account. The bank will keep track of everyone you pay out money to (which you can review on your online statement). With the Company (or individual's) name, the zip code, and the account number, the bank can use its own database to search for that company's address, bank, and account. Even if you don't have the account number (say if you are paying an individual) or the bank isn't able to find the company you're trying to pay, you will be prompted to enter an address for the payee. The bank will then print a physical check to send to that company or individual.





Step Two: schedule a payment. Now that you have the payee saved in your account, you can set the amount you want to pay and when you want to pay it. If you have more than one account with the bank, they will ask you which account you want to pay out from. Sending the payment is as easy as clicking a button at this point. Any time you want to make another payment, you can return straight to this screen, enter a new amount, and send off a new payment.

Step Three: With repeating payments, online banking gets even easier. If you have a bill that requires you to pay a specific amount of money every month (or week or year, etc…) such as rent or a mortgage, you can set that up to happen automatically. Here, you select who you want to pay, how much you want to pay, how often you want to pay it, and what day of the month it needs to be paid on. The memo is for you so that you can see on your statement what each payment is for. Selecting "no ending date" will keep the payment active until you choose to stop it.



With this process, you never have to write a check, in this case to your landlord, again. I also don't have to worry about forgetting one month and having the landlord come knocking on my door. It is still very important to keep on top of your balance. It's very easy to run into trouble if you don't bother to check on your account. Using online banking doesn't save you from fees or from bouncing a payment; it just makes the payments themselves much more convenient.

Notice that, even though the process is different, the information we needed to enter is still the same as when we wrote out a check.

- The amount of the transaction
- The date of the transaction
- The name of the payee
- The purpose of the payment

The only thing we really aren't doing is writing everything out long-hand. This sort of banking also allows you to see all your account balances (if you have a savings, checking, and loan from the same bank) all on one screen at one time. Some banks, like in our example, also allow you to set a financial goal for different accounts and easily see how much progress you are making toward those goals.

INSTRUCTOR TALKING POINT

Talking about ease and convenience... Believe it or not, depositing a check can be as simple as taking a picture with a smartphone. Forgot to stop at the bank and need to deposit a paper check? Take a photo of the front and back of the check (showing your endorsement) with your phone. The bank will take the image and deposit the payment into your account by using the routing and account numbers on the check.

Balancing Your Checking Account

Balancing your checking account on a frequent basis, monthly or even weekly, is part of the deal. Why? There are two main reasons to balance your account:

1. To avoid insufficient fund fees at the bank and at the businesses where you use checks.
2. To correct possible bank errors.

No one can afford to bounce a check. Most banks now charge in excess of $35 per bounced check and most stores now charge a fee when you bounce a check written to pay your bill. The cost of making a single mistake can cause financial strain. If you earn $10 per hour, you have to work almost four hours to recover the money wasted from bouncing just one check. It makes sense to balance your checking account within 48 hours of receiving your bank statement, or online, once per month to make sure there are no mistakes in your balance. How do you balance your checking account? You do that by keeping your checkbook register current, and recording all deposits and withdrawals from your account in a timely manner.

What Do You Need to Balance Your Checking Account?

Your bank will give you everything you need to balance your checking account. When you open a checking account the bank will give you three things: temporary checks, a register, and a vinyl checkbook cover to store the checks and register. To balance your account, you simply record, in the register, all of your deposits and withdrawals. Remember that withdrawals occur in many different ways:

- Writing a check that is cashed
- ATM withdrawals
- ATM fees (your bank and other banks)
- Traveler's checks, counter checks, and cashier's checks charged to your account
- Wire fees, coinage fees, service fees, etc…

Anything that causes your account balance to decrease is a withdrawal from your account. Most people don't bounce checks because they don't know how much money they put in the account. They bounce checks because they forget to subtract all those little fees. For example:

INSTRUCTOR NOTE

It can be useful here to have a student read the Tyrone story and keep track of the finances on the board as the numbers are read. Here is how it breaks down:

What Tyrone thinks is happening	
Starting Balance:	$1,060.00
Gas:	$47.00
ATM money:	$50.00
Altoids, Gatorade, Chips:	$10.00
Electric Bill:	$80.00
AT&T:	$98.00
Rent:	$775.00
Total remaining:	$0.00

Tyrone now has $687.00 to pay his $775.00 rent, and he has a problem.

What's really going on	
Starting Balance:	$1,060.00
Gas:	$47.00
ATM money:	$50.00
ATM fee:	$1.00
Bank fee for using outside ATM:	$2.00
Altoids, Gatorade, Chips:	$10.00
Electric Bill:	$80.00
AT&T:	$98.00
Total Remaining:	$772.00
Rent:	(returned as a bounced check) $775.00
NSF fee for bounced check:	$35.00
Remaining Balance:	$737.00
Late fee from landlord:	$50.00
Usable Balance:	$687.00

Tyrone's been working hard all week at Credit Bureau in Tampa, but the weekend is coming up. That means he'll be going to visit his wife Leesha at Lowell C.I. She really looks forward to his weekend visits, and he can't wait to see her again. He's got bills to pay by Monday. AT&T wants $98, there's the rent for $775, and he's pretty sure that he owes $80 on the electric, but there was still $1,060 in his checking account the last time he checked. But… the bills are all set up for automatic payment in his online account, so he doesn't really have to worry about it. He's got an account with Fells Wargo Bank, and they're always good. Besides, he's got other things on his mind. To get ready, he puts $47 in the gas tank to make sure that he won't run out of gas, and he gets out his best clothes the night before.

The next morning, he sets out, a little sleepy but with a smile on his face, thinking of everything he'll have to talk about with his wife and about giving her a big hug. He gets halfway there before he realizes that he forgot to get some cash to bring with him so that they can buy some food at the visitation park. How could he have been so stupid? He pulls into a little convenience store where they have an ATM and withdraws $50 in cash. He uses his debit card to get some chips, a Gatorade, and a tin of Altoids so that his breath will smell nice and fresh when he sees Leesha. The bill comes to $10.

The visit with his wife goes great. It's always hard to see her in prison wearing that inmate's uniform. It tears him up inside to sit and talk with her and know that he can't take her home. But, they had a good time still. He got to hold her, and they had some good laughs talking about the past and things that had been happening at Credit Bureau. Tyrone's co-workers are always a source of good stories. At the end of the visit, Tyrone heads back to Tampa with a bittersweet smile on his face.

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On Monday morning, the bank attempts to pay the bills he has set up for automatic payment. First, the electric bill payment goes out for $80. That keeps them happy and Tyrone's lights on. Next, AT&T gets their $98. That keeps Tyrone's new smartphone working. Tyrone goes off to work without a care in the world about his finances. In fact, he has to deal with a thousand other people's finances at his job. All those idiots sending him letters whining about their credit reports aggravate him to no end. Why can't they be like him and keep on top of things?

On Tuesday evening, he gets a knock on the door. His landlady, Mrs. Harridan, looks furious. She takes a deep breath and yells, "The rent was due on Monday! You can pay up or GET OUT!"

He assures her it must be some sort of mistake at the bank. He has the rent set up for automatic payment, after all. He pulls out his phone and quickly checks his account. He looks in utter confusion at his balance: $737.

"This can't be right," he says, his breath quickening in anger. How could the bank have screwed up his rent? Then, he notices an alert that was sent to his account yesterday. An insufficient fund fee of $35 had been charged to his account when his rent payment had been processed with a balance of only $772. That still wasn't right! He checks his account activity, and then he sees it. There was a charge from Dru's Convenience Mart for $10. Just before that an ATM withdrawal from MoneyPeople ATM at Dru's Convenience Mart for $50 along with a $2 charge from Fells Wargo for using an out-of-network ATM and a $1 charge from MoneyPeople for using their services. $3 in ATM charges had caused his rent payment to bounce!

Tyrone felt like throwing the phone against the wall. He yelled and flexed and stomped his feet on the ground. Mrs. Harridan didn't look impressed. She screamed right over him about the rent being due. He had to promise to get it taken care of within the next two days AND pay a late fee of $50 before she would even leave. He felt furious. A lousy $3 fee had just cost him $88 extra; and where was he going to come up with an extra $88 before payday?

Tyrone's situation is, unfortunately, not unusual. Believe it or not, he was actually lucky. Banks and businesses can attempt to redeem checks or online payments up to three times before it's declared a void transaction. That would have been a $35 NSF fee for every attempt for a total of $158 in extra charges ($35 + $35 + $35 + $50 late fee = $158). Add to that the $50 late fee charged by his landlord and suddenly Tyrone owes an extra $208 on top of his rent (along with that $3 ATM fee he didn't notice). It's very important to keep track of every fee that gets charged to your account.

INSTRUCTOR TALKING POINT

That's right. $35 per attempt, and they're allowed to make three attempts. It can actually get even worse than our example. In Tyrone's case, he was dealing with his landlady directly. If he had been paying a company (for utilities, for example), it's also common that the company can charge a $25 processing fee every time a check bounces when they try to deposit it. That would equal:

$35 + $25 + $35 + $25 + $35 + $25 = $180 (and that's just in fees)

Suddenly, a $75 light bill can balloon into a $255 debt just for bouncing a single check. It's very important to balance your checking account and check your account balances to make certain that no mistakes are made. Insufficient fund fees can completely destroy your budget and your finances.

While we're on the subject of fees, why did Tyrone get charged by BOTH Wells Fargo and MoneyPeople for using an ATM? Wells Fargo because banks run on fees. Remember, if you are *their* customer; they want you to use *their* services. When you sign up for an account it spells out the fee for using non-Wells Fargo ATM's. MoneyPeople charged Tyrone simply because they could. The ATM that they put in a convenience store is not affiliated with a bank, and, believe it or not, they are not simply giving money away out of the goodness of their hearts. That fee that they charge you is the only way they have to get money from you for using their services. ATM fees are a very commonly overlooked charge. It automatically deducts money from your bank account when you click ok on the ATM screen, and those small amounts can add up fast.

With online banking that becomes a lot easier. If Tyrone had taken the time to check his account after his visit to Dru's Convenience Mart, he would have noticed the extra charge. He could have possibly postponed one of his other bills or made some sort of arrangement to keep from having to deal with his landlady. At the very least, it would have been easier to come up with an extra $3 than an extra $88. That's why it's vitally important to balance your checking account.

On paper, balancing your checking account starts by accurately recording each deposit, withdrawal, and fee in your check book register. First you write the check number and the date, and then you write a brief transaction description to serve as a reminder of why you wrote the check. Next, you record the amount of the check. The final step involves some basic math that you can do at the same time you are writing the check or you can wait until you have a calculator. The balance in your checking account changes with each check you write, deposit you make into your account, or fee you incur. Each time you make an entry into your register you add or subtract the transaction from your running balance. Here's an example of properly recorded transactions in a check book register where the starting balance in the account is $150.

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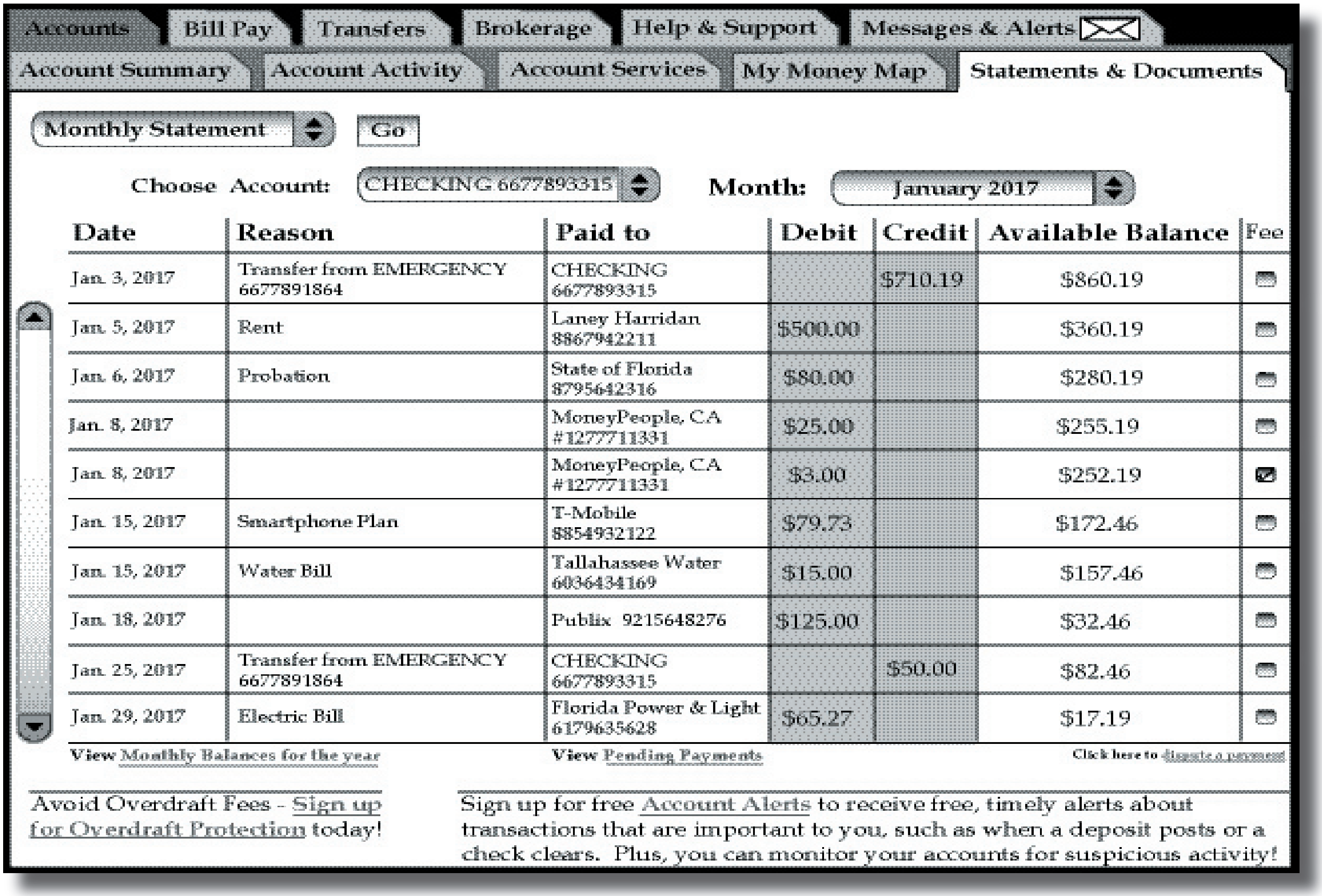
Example Checkbook Register

Check Number	Date	Fee	Transaction Description	Payment	Deposit	Balance **$150**
	1/3		Money X-fer		$710.19	$860.19
5672	1/5		Rent	$500.00		$360.19
5673	1/6		Probation payment	$80.00		$280.19
	1/8		ATM withdrawal	$25.00		$255.19
	1/8	x	ATM Fee	$3.00		$252.19
5674	1/15		Smartphone payment	$79.73		$172.46
5675	1/15		Water Bill	$15.00		$157.46
5676	1/15		Groceries	$125.00		$32.46
	1/25		Money X-fer		$50.00	$82.46
5677	1/29		Electric Bill	$65.27		$17.19

Again, online banking makes this all a lot easier. Below is an example of an Account Summary screen from an online account. It tracks all of your transactions and fees in real time which relieves you of having to write out everything by hand. Many people still do both a handwritten register and an online account summary because…

what happens if the bank's website is unavailable for some reason when you need to know the balance of your account? Others maintain a printout of their records on a regular basis, but printer ink can get rather expensive to keep doing that. It is always advisable to keep a physical written backup of your information in case of emergencies (loss of power, disruption of cell service, etc…).



Date	Reason	Paid to	Debit	Credit	Available Balance	Fee
Jan. 3, 2017	Transfer from EMERGENCY 6677891864	CHECKING 6677893315		$710.19	$860.19	☐
Jan. 5, 2017	Rent	Laney Harridan 8867942211	$500.00		$360.19	☐
Jan. 6, 2017	Probation	State of Florida 8795642316	$80.00		$280.19	☐
Jan. 8, 2017		MoneyPeople, CA #1277711331	$25.00		$255.19	☐
Jan. 8, 2017		MoneyPeople, CA #1277711331	$3.00		$252.19	☑
Jan. 15, 2017	Smartphone Plan	T-Mobile 8854932122	$79.73		$172.46	☐
Jan. 15, 2017	Water Bill	Tallahassee Water 6036434169	$15.00		$157.46	☐
Jan. 18, 2017		Publix 9215648276	$125.00		$32.46	☐
Jan. 25, 2017	Transfer from EMERGENCY 6677891864	CHECKING 6677893315		$50.00	$82.46	☐
Jan. 29, 2017	Electric Bill	Florida Power & Light 6179635628	$65.27		$17.19	☐

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You also need to balance your account when you receive your monthly bank statement. Most modern checking accounts will now provide you with both a statement in the mail and an online statement. Some banks offer accounts with lower fees if you use an online statement only (since it's cheaper for them to do it that way).

Here's the challenge with receiving mailed statements: The bank takes a snapshot of your checking account on a particular day of the month (say the 15th, for example). That snapshot includes all activity in your account from the 16th of the previous month to the 15th of this one. The bank processes their statement and mails it to your address and you receive it three to four days later around the 19th or so. The only way the information is useful is for you to reconcile it to the 19th. After all, the balance four days ago is not much use to you today. Think of it like receiving your inmate account statement here. We receive them on or around the 9th of the month, detailing the activity in your account for the previous month. It also is only partially useful as it tells you what your current balance was 9 days ago.

Where do you start with this? The solution is easy. You start by putting a check mark in your register for each of the checks and deposits included in your bank statement. Once that's done, it's easy to see which checks have already cleared your account for payment. Those checks that have not yet been cleared for payment remain outstanding and have to be subtracted from the balance as of the 15th on the bank statement.

The Reconciliation Sheet

The bank provides you with a reconciliation sheet on the back of your monthly bank statement. The reconciliation sheet is used to bring your bank statement forward to a current date, in our example, from the 15th to the 19th.

On the reconciliation sheet, list any withdrawals or fees that are in your checkbook register but not on your bank statement, and total the list.

Then list any deposits that are in your checkbook register, but are not included on your bank statement. Total the list again.

Balancing Your Checkbook — **Balance**

List the closing balance from your bank statement. In the example, the last check cashed before your statement was generated was check #5675. — **$157.46**

Publix	**5676**	1/15	$125.00
Florida Power & Light	5677	1/29	$65.27

Total = $190.27 — **- $190.27**

List deposits to your account that are not on your statement: (Deposits in transit)

Transfer from Savings Account	**Deposit**	**1/25**	**$50.00**

Total = $50.00 — **+$50.00**

Your new checking account balance as of the 29th: $17.19

Beginning with the ending balance from your bank statement, subtract the total withdrawals and add the total deposits that were not on your statement. Compare your reconciliation sheet with your checkbook balance. If they do not agree, you need to double check your lists and re-add your checkbook entries until you find the difference.

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Modern Checking and the Internet

The good news with online banking is that all that reconciliation work is unnecessary. You can access your checking account information anytime and anywhere with a smartphone. With today's technology, your ATM cash withdrawal will show up online within minutes of completing the transaction. This means you can check your balance in real time 24 hours a day and you don't have to do any of that math. As we mentioned, signing up for online banking and payroll direct deposit will usually get you a further discount on the bank's basic service fees. It's a great way to do your banking, and the banks prefer it as well as it cuts down on their costs.

Banks Make Mistakes

There's one more big reason to balance your checking account and be aware of what your finances should look like, and that is to make sure your bank or credit union has not made a mistake in handling your transactions. The reality is that banks make mistakes. Bank tellers are human beings entering millions of digits of data while staring at screens all day long, often multi-tasking at the same time, and humans make mistakes. Think about a deposit made by a customer for $500.00 which the teller then accidentally keys in as $50.00 – she missed one zero. A back line "proofer" verifies that the deposit matches the actual check, but that person is also human, and they are moving through millions of transactions. Banks make mistakes every single day. Inevitably, they will make one on your account at some point. It is your responsibility to verify your deposits, credits, and to track your balance. If the bank makes an error that causes your bill payments to bounce, it is their responsibility to rectify that mistake, but it's your responsibility to hold them accountable. There are three people that need to check that all of your deposits and withdrawals are accurate – the bank teller, the back-line proofer, and you.

INSTRUCTOR TALKING POINT

I know it's hard to believe that banks make mistakes, but they do. Banks process millions of transactions every day. Let me repeat that: millions. If a bank was 99% accurate that would be really good. If your bank processed only 1,000,000 transactions per day with a 99% accuracy rate that means it would mess up 10,000 items per day. Assuming they are open 260 days per year (no weekends or holidays) that means 2.6 million transactions get messed up every year. The possibility of one or more of those eventually being your transaction is fairly good.

Here's another of those banking secrets: Bank managers get paid commissions on some of the fees they take in from their customers. If you're like Tyrone and just assume you know how much is in your account without checking or balancing your checkbook it could cause you to overdraw your account just like he did. What happens if you deposit a check for $500 into your savings account, but the teller enters it as $50? A day later, you write a check to FPL for $125 for your utilities. The check bounces. A week later, you start getting late payment notices and stern messages from the bank that your account is severely withdrawn. Not only that, but you've been charged three $35 NSF fees and a $75 processing fee from FPL in addition to a $25 late charge for missing your payment.

Okay, you know that can't be right. So, you check your account balances and, sure enough, the bank made the mistake. You have the original check and the deposit slip. You can prove it. So, you call the bank and let them know that they made an error and you are now looking at $205 in extra charges on top of your original $125 bill from FPL. The bank manager apologizes and asks you to send in the original check and deposit slip so she can correct the error and communicate with FPL to clear your account with them. You hang up the phone satisfied that everything is fine. Right?

Well, the bank is obligated to correct their error. So, they take on the liability for the $100 in fees from FPL for the mistakenly bounced check. They also have to correct the deposit amount to reflect $500 instead of $50. So, they will add $450 into your account. You were also charged three $35 NSF fees for the attempted withdrawals on your account. So, they refund you $35 for that. Problem solved.

Is it? The bank charged you ($35 x 3 = $105) in NSF fees. Why are they only returning $35? That means you only have $430 deposited into your account from your $500 check. The FPL payment clears now. But, that leaves you with $305 in your account instead of $375. Didn't the bank just cheat you out of $70, *after* they screwed up your account?

Actually, the mistake in this case was yours. Remember way back when, when we were talking about opening a bank account, we mentioned a signature card? If you were opening an online account, you would have signed a digital signature card. [It can be a good exercise here to get the class involved by having a student sign a "signature card." Give them a piece of scrap paper with something scribbled on the back and ask them to sign it so you can have a record of their signature] The explanation for that is that they need a record of your signature to compare against checks you write in order to verify that you actually wrote that check. That is, technically, one function of the signature card. How many of you have ever read the *back* of that signature card?

The signature card that they have you sign is actually a small contract with lots of fine print. One of the most common items on the card is a provision that states: if you don't balance your account within 48 hours of receiving your statement and contact the bank with any errors within that time (and you have even less time with a digital account since your balances are almost instantly available), you will not be refunded any NSF fee amounts incurred by the oversight. By signing it, you agreed to it, and it *can* come back later and bite you.

Now, if you happen upon a particularly generous bank manager (or if you are a particularly valued customer – one with multiple accounts in good standing) they might refund more money to you. But, don't forget that the bank manager makes *her* money by the amount of fees charged. The branch manager may receive a commission of around 5% of total fees. She'll have a goal that she is supposed to meet (say $1,500 in fees). Just like any sales job where commissions are involved they take out any amount that may be returned to customers. It doesn't do any good for a business to sell $1,000 worth of anything if $750 is returned. You would rather have your people sell $500 with $0 in returns. So, if this particular manager has $1,500 in fees for this month and she is receiving 5% of the total or $75, anything returned is taking money out of her own paycheck. It's not in her interests to refund *any* of your money. Most banks will be lenient and refund one of the charges, but they don't have to do even that much. And, if you call back to scream at the bank manager *again*… guess what?

Always balance and be aware of your account balances. What about savings accounts? Do they need to be balanced as well? Of course they do. They don't see as much activity as a checking account, but that just means that it's easier to let a mistake slide. You might not find a mistake in your savings account for a month or three.

INSTRUCTOR TALKING POINT

Let's say you find that mistake 3 months after it happened in your interest-bearing savings account. How much interest do you think you're due? If you're being paid 3% interest on your account your interest should have been calculated as follows:

Jan 15	$450.00 mistake
Feb 15	$1.13 interest
Mar 15	$1.13 interest
April 15	$1.13 interest

The bank is only obligated to pay you the April 15 interest payment. I know you're probably saying we're only talking about two missed payments of $1.13 or $2.26 overall, so what's the big deal? The big deal is that it's FREE MONEY that you just bilked yourself out of!

Incidentally, the branch manager is more likely to give you your interest back than they are overdraft fees, because it doesn't come out of her commission. Your relationship with the bank is the biggest thing working in your favor in these cases. The more accounts you have with the bank – checking, savings, CD's, car and mortgage loans – the more likely it is that the branch manager will be favorable to you in the case of errors.

Let's say that you aren't like Tyrone. You balance your checkbook every month, within 48 hours of receiving your statement (or you check it daily on your smartphone). You're one of the good guys. The bank calls you and tells you that your account is overdrawn. You know that there is no way that your account is overdrawn. So, you go into the bank and talk to a customer account representative. You take your latest reconciliation and your checkbook register with you (or a printout of your account screens) and you and the account rep go over it and find that the bank made a mistake.

The branch manager will give you the overdraft fees back with no problem in that case and probably apologize repeatedly. You honored your part of the contract, after all. You walk out of the bank happy, right? I wouldn't walk out yet, you may still have a fee to pay at Publix or wherever the check had bounced. Have the branch manager call the company and explain what happened. They may not do this automatically, so it's best to ask.

INSTRUCTOR TALKING POINT

Before we finish with checking accounts allow me to let you in on one more secret. It used to be that banks did not want customers that bounced checks. The credit market started getting tight, and the bank had to come up with another way for the banks to make money. Then some bean counter started analyzing financial statements and looking at the amount of fee income that they were receiving and said, "Uh… This is a great source of income."

So banks started courting that type of customer. The banking systems have certain codes in them that tell the customer service representatives what type of customer you are. It's important for them to know up front when they're talking to you if you're a profitable customer to the bank. The systems are usually very simple. For example, some use a stoplight sort of system with a red, yellow, or green light.

- Red light: you're not a profitable customer – you only have a checking account with a small balance. Not really a great relationship for the bank.
- Yellow light: you have a couple of accounts and are making the bank some money.
- Green light: you're an extremely profitable customer.

Customers may only have one account with the bank and not a large balance but have lots of overdraft fees, but they pay their overdraft fees regularly. That's a green light customer. The bank wants that customer because he doesn't know what he's doing. He's willing to overdraw his account on a regular basis and just hand a bunch of extra money to the bank in exchange for it. Sounds great to the bank, right? Let's face it, that bank is in the business of making money, and they really don't care where that money comes from. If it's from fees, then their bottom line is going up with that customer the same as if they were charging high interest rates.

Think we're overblowing the amount of money banks make on fees? Consider this: In a recent poll, USA Today asked Americans what is the most important feature in a checking account? 41% said 'No Monthly fees,' 22% said 'No ATM fees,' 11% said 'Free online bill pay,' and 8% said 'Minimal Overdraft fees.'

With only 8% of the American population worried about overdraft fees, guess how much US banks collected in those overdraft fees in a single year? $33,600? No, I think I left out a zero or two. It's $33,600,000,000! There were 1.12 Billion overdraft transactions in 2016, totalling $33.6 billion dollars (up 2.5% from 2015).

The Checking Account Alternative

I promised that we would look at the alternative to using a checking account later and the time has arrived. Instead of using a checking account, what if we decide to use a check cashing store to cash our paychecks? Well, let's look at the reality of that option in the light of your goal to build wealth.

According to the FDIC, 25% of all U.S. households lack bank accounts and use check cashing services and other alternatives to banks. There are now practically as many check cashing stores in every city in America as there are bank branches. Let's stop for a minute and ask why. The answer is simple: check cashing is a very profitable business. I will hold back no punches when it comes to using check cashing stores. You are fools soon parted from your money if you use a check cashing store instead of a bank or credit union.

For example, say you don't want to hassle with a bank. After all, you have to take the time out of your day to open the account. There are minimum opening deposits to start with. Then you have to maintain a certain balance in the account or pay a $10 fee every month. That's way too much to think about and deal with. Instead, you get your paycheck on Friday evening and head directly for the local check-cashing store.

Let's assume your paycheck is $500 for the week. The check cashing store charges you 8%, but you think it's worth it because you get your money right now without all the hassle. What's the cost of that convenience? Eight percent of $500 is $40. You do this every week when you pick up a check, and you collect 50 paychecks per year (We're taking two week's vacation to Daytona).

That is $40 x 50 weeks, which means you spend $2,000 per year for the privilege of having your money *now,* without all the hassle ($40 x 50 = $2,000). All that money lost just to save 30 minutes at the bank opening an account and $120 per year to maintain your account ($120 that you can avoid by using direct deposit or maintaining a minimum balance, sometimes just by using your debit card!)! *$2,000 a year*! Even if you pay the monthly checking account fee every single month, you'd still be paying an extra $1,880. What could you buy for $1,880?

INSTRUCTOR TALKING POINT

How much is your time worth? If you were upset over the fees that banks charge, check cashing stores multiply those fees exponentially. You would have just saved almost $2,000 simply by *not* using a check cashing store! When we get into the retirement section of this manual – you are going to be saying, "I don't have the money for retirement." But by making just a couple of changes in the way you do things you actually *can* have the money. You just need to use it properly. Discipline and Sacrifice isn't necessarily about giving things up. It's more about changing the way we think.

What about Money Orders? Instead of having a checking account, can't you just get a money order when you need to issue a check? It's certainly an option, but it holds the same hidden fees in addition to the dangers of cash (they can be lost or stolen). If you have to issue only 4 payments each month, just a $1.50 charge per money order can cost you $72 per year. I don't know about you, but I don't have $72 laying around that I could really do without. Just by using direct deposit, I can take the monthly fees off the table with a Checking account. Looked at another way, that's $72 in my pocket.

Money Orders and check cashing stores are not very good alternatives for a Checking Account.

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Money Saver! The better question is, "What would $1,880 a year be worth twenty years from now, if invested in a good growth mutual fund?" The answer, assuming a 6.5% average annual rate of return for 20 years, is $77,736.03. That's just one year of cashing checks!

As we talked about in the last chapter, we pay a lot just for convenience. In terms of food, we could pay $5 for 1 pound of ground beef. You could use that to make four of your own quarter pounder cheeseburgers for $1.50 each. Or, you could go to McDonald's and pay $3 per cheeseburger. $6 to make them ourselves versus $12 to have someone do it for us. Most people don't mind paying double the price every once in a while for the convenience. Some people don't even bother to think about it. In the case of banking, though, are you willing to pay 1,470% more every year just to use your own money? Worse, with the money you are wasting, you're throwing away an investment worth $77,736.03. What sounds better for you and your wealth, paying out $37,600 or gaining $40,136.03?

The Modern Alternative to the Check Cashing Store

Today's Super ATM's allow you to scan your check into the ATM and immediately withdraw $100 – $300 depending on the amount of the check. If you have a checking account with the bank you can use the Super ATM for free. Don't use check cashing stores!

INSTRUCTOR TALKING POINT

As we've been mentioning, new technology is making banking easier every day. Super ATM's allow you to deposit your check without a teller, but you don't even have to do that to make a deposit anymore. We said before that you can make a deposit with only a photo taken on your phone. There are apps to alert you to low balances, apps to track your purchases, and apps that send you a message any time a fee is charged to your account. Technology is great for saving time and allowing convienience but, once again, don't let that lure you into a false sense of security. Guard your phone if you use it for banking. They also have apps to help with security (such as the ability to wipe the memory of your phone remotely or track its location).

In preparing for the next chapter it is important that you understand the difference between regular banking products and *credit.* A bank account is an example of a regular banking product. *Credit* can be numerous things such as credit cards, auto loans, lines of credit, mortgages, etc. Credit is defined as '*the provision of money, goods or services with the expectation of future repayment*.' A pre-paid credit card is NOT a form of credit; it is simply a bank account that you establish with a major credit card company without any of the regular benefits you would receive from a normal bank account. Although a pre-paid credit card allows you to have the convenience of a credit card your receive none of the benefits. All the money you spend off of a pre-paid credit card is YOUR OWN money. A pre-paid credit card will also cost you extra in fees and service charges. Instead of costing yourself more money using a pre-paid credit card why not establish a regular bank account with a debit card or get a regular credit card and build your credit score?

So... let's take a look at credit and how to use it...

REEFS

Chapter 3 - Credit & Debt Strategies

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Rachel was a woman of the world, a tall, dark, and sensuous woman with a beautiful voice and an amazing figure. At 19, she enrolled at the local college, ready to start earning her degree in telecommunications and take the radio world by storm. She worked hard, DJ'ing at the college radio station and interning at a local station. She got a part-time job as a barista, and, not long after that, the credit card offers started to come rolling in. She must have been doing well! All these credit card companies wanted to just throw money at her!

It was difficult, but she managed to keep her head above water (barely). She got a fantastic apartment in a great part of town. She even qualified for a bank loan to buy a brand new Ducati Motorcycle! Rachel was living the American Dream. She loved her job, had some great friends, and a wonderful lifestyle. But, Rachel had a problem. She grew to love expensive things and the status that they gave her with the neighbors. She came to believe in "retail therapy." Before long, she had seven credit cards carrying a heavy balance, a hefty student loan, the bank loan for her impressive motorcycle, and, as a personal graduation present to herself, a new Dodge Charger (The terms were great – "No down payment? No Credit? No Problem!!").

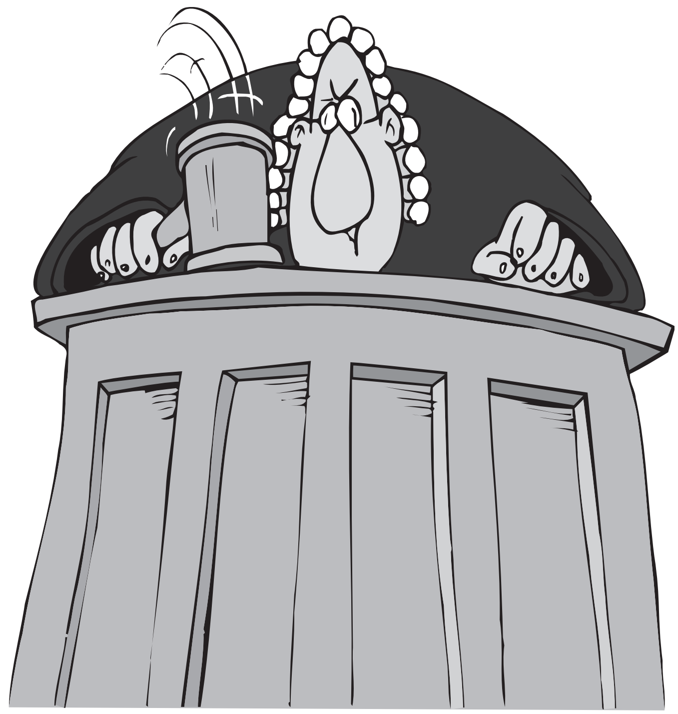
Out of college, she was a little disappointed that no one immediately wanted to hire her as a Prime Time DJ, but she was willing to work her way up through the ranks. It meant she had to keep her part-time job, but she was definitely on the road to success.

It wasn't long after that the problems started. One day, three years after her graduation, on her way home from work, she was sleepy, the phone kept going off, and, before she knew it, she'd wrapped her beautiful Charger around a concrete light pole. In three years, Rachel's car had depreciated well over half of its value. Rachel, like most people, had been making minimum payments on all her bills, including her car loan. She now owed more on her loan than the car was actually worth. The car wasn't totaled, but the repairs came to a lot more than she had lying around. No problem! That's what credit cards are for, right? They were close to being maxed out, but it wouldn't put her all the way over the limit.

She didn't account for the extra interest on the payments that carry over from month-to-month. Even making the bare minimum payments, Rachel wasn't able to keep up with her new credit card bills, on top of her student, car, and bank loans. She missed several payments, and the interest kept stacking up. Soon, she began receiving phone calls from the Credit Card companies and the Collection companies weren't far behind. Before she knew it, her credit cards were cut off. Not long after that, the bank repossessed her Ducati! She walked out of work to find that her Charger had been repossessed on the same day! Frantic, Rachel did not know what to do. She needed to be able to get to work. And, what would the neighbors think if they saw her with no motorcycle, no Charger, walking around with no expensive things?!?

Desperate to maintain her lifestyle, Rachel came up with a plan. It was the solution to all her problems! As a barista, she handled hundreds of credit cards every day. Sure, they may have belonged to other people, but it's not like it was really *their* money or anything. It was just credit! And, she didn't need that much. She'd just borrow a few card numbers, a few names; before she knew it, she'd be right back on top!

Rachel's plan actually worked! For a while… Until one of her customers happened to notice and film her on his Smartphone writing down credit card numbers and names. Rachel ended up becoming a celebrity! She was on TMZ as well as the local News! Rachel was arrested and charged with identity theft along with several other felony charges. She ended up serving five years in prison. And, what did the neighbors say then?



This chapter is about *not* turning into Rachel. In it, we will cover many strategies to handle basic credit and debt situations. We will help you to develop a plan for your credit and also deal with any debt you have or could encounter. The key to any personal financial strategy is to live *within* or *below* your means. Rachel could not manage her own income. If you are the same, you do not need to have access to credit. Credit is a very important factor financially, and you should think of it like an infant; it is delicate, precious and will eventually grow to become a major part of your life.

Credit cards are an important piece of your overall strategy for financial health. Credit cards are the first step in building credit and demonstrating your ability to be responsible, dependable, reliable, trustworthy and stable. If you misuse credit or credit cards, the short-term damage can cause long-term destruction. To be blunt, manage credit effectively today and you can enjoy it tomorrow.

INSTRUCTOR TALKING POINT

Although credit cards are the most popular financial tool in our society (and they can indeed be helpful), if not properly managed they can be equally deadly. The main institutions that sponsor credit cards are Visa, MasterCard, American Express, and Discover. Credit cards typically include a 16-digit ID number to identify you as the card holder. As a point of reference, the first three digits of American Express are always 37, Visa: 48, and MasterCard: 43. This can be a great reference to identify the card itself without having it in your possession.

Some of the most important and valuable benefits to owning a credit card are: a) The ability to track your expenses b) Vastly increased buying power (by using O.P.M. or Other People's Money) for 30 days c) A chance to develop your credit/build your credit d) The ability to manage your credit score e) The ability to make Large Purchases f) A safety net in Emergencies.

Credit cards, if used properly, can be a great tool to exhibit discipline, consistency, and transparency in your financial footprint. If (or WHEN) you get audited by the IRS, your credit card statements could make life much easier. The government is never good at following its own expectations, but, as far as they are concerned, the more transparency *you* have, the safer you are in *their* eyes.

A credit card can help you pay all your bills on time, it can keep track of your payments through electronic transactions and create a positive paper trail (Major credit card companies provide quarterly itemized lists of all your expenses). What are the benefits of using a credit card responsibly? You will:

- Be able to keep track of all of your expenses
- Be ready for any financial audits or examinations (taxes, IRS)
- Allow YOUR money to earn interest for 29 days
- Build your credit score
- Obtain more credit
- Make large purchases
- Have a financial safety net in emergencies
- Utilize less cash
- Most importantly, it will keep you ready to qualify for loans with banks or creditors.

But, credit cards can cause serious financial problems if we use them the wrong way. What we need is a strategy, a way to use our credit cards so that they work for us rather than against us. Used in the right way, a credit card can lead us to financial freedom, fast.

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Credit Card Strategy

Before you sign up for any of those credit cards you get offered you should have a strategy for how to choose the best offer available. Without a strategy, you are more likely to take an offer that will eventually cost more than any potential benefits. Knowing this strategy gives you the power to control your financial life. A credit card should be an *asset* for building credit and wealth not a *liability*. Choose wisely when you select a credit card.

1. Select credit cards that are appropriate for you, a sufficient number of credit cards can range from 2 to 5. The amount you obtain depends on your budget and your expenses. When looking for credit cards, you want to find the best offer available. The best ways to find credit cards are through: banks, credit unions, major credit card websites (Visa, MasterCard, Capital One), but also through consumer websites like: *nerdwallet.com, bankrate.com, Indexcreditcards.com*. When reviewing the offers for credit cards you should concern yourself with the fees, the interest rates, the payment cycle, and any potential rewards.

Above all, as we discussed in Chapter One, comparison shopping is always a necessity. For example:

Credit Card Comparison*		
Cards:		
Intro Purchase APR (note that after this period your interest rate will become the regular APR for purchases amount)	0% for 21 months	0% for 15 months
APR for purchases (variable based upon creditworthiness)	12.49% - 22.49% (variable)	15.65% - 25.49% (variable)
APR for cash advance	25.74%	24.49% - 26.49% (variable)
Grace Period	23 Days	Unknown
Annual Fee	$0	$0
Late Payment Fee	Up to $35	N/A
Cash Advance Fee	$10 or 5%, whichever is greater	5%
Returned Payment Fee	Up to $35	N/A
Penalty APR	Up to 29.99%, based on your creditworthiness	Unknown

* Source: Comparecards.com (January 2017)

Choosing the Best Credit Card

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Have you ever been watching TV and during the commercial an ad comes on for a law firm or a new type of medication? Throughout the commercial, a parade of small print usually flashes by on the bottom of the screen much too fast to actually read. Beware of that small print. When choosing a credit card, you *need* to know the details when you review the application. Some cards allow 30 days to pay before incurring a finance charge, some only allow 21, and others allow something in between; the longer the payment cycle, the better the credit card.

Note the interest – is it 10%, 16%, 18%... more? You need to know just in case something goes wrong like a check you sent gets lost or your electronic bill payment does not get processed.

Choose a card with a reasonable annual percentage rate. The APR is what you pay on any balance you don't pay off each month (the interest). Typical credit cards have APR's of 17.4% - 21%. Find a credit card with the lowest annual percentage rate.

The first couple credit cards you are offered when released from prison will have the worst possible terms: a

21-day payment cycle, 18+% interest, and an APR of 21+%. As your employment record and income improves, your credit and financial strength will improve, and as they improve, so will the terms of the credit card offers you receive. The ideal might be: a 31-day payment cycle, 10% interest, and an APR of 17.4%. Of course, if you use the credit card strategy correctly, interest and finance charges will never come into play because you are paying your balance in full each month, and that means the only cost you pay is the annual fee (and most of the time you can get that waived). After six months of utilizing a credit card and being responsible you should contact your card issuer and negotiate for better terms: lower interest rates, higher amounts of available credit, lower interest fees, lower annual fees.

If you have bad credit or no credit you still have the ability to obtain a credit card. The two major credit card companies that offer "starter credit cards" are Visa and MasterCard. A starter credit card is a low credit limit credit card with high interest rates. Starter credit cards will: a.)require you to pay large amounts in fees or b.)make an initial deposit for the amount of credit granted. Starter credit cards typically range from $300-$500.

The requirements for a Starter Credit Card

- Job/Verifiable Income
- Social Security Number
- Bank Account
- Address

INSTRUCTOR TALKING POINT

Our society is built on credit and there are plenty of options available to you, once again the world will take you seriously if you exhibit the ability to manage your credit. Your priority is to select a card with the least amount of interest offered; however, you need to read the small print. EVERY TIME. If you don't then you are willingly becoming a victim. You need to be keenly aware of the terms of the long-term contract from the credit card company as they have the tendency to increase the interest after so many months (Sign up now! New cardholders receive a special low interest rate of 10% just for signing up! Don't delay. Interest rates apply for first six months. After this term of six months, interest rates will be raised to 21%). Always be aware that Credit Card companies exist to make money. They don't exist to do you favors. In the world of interest rates **every single point counts**.

2. Utilize your credit cards to pay your monthly expenses. A credit card can be used to cover all your monthly bills: electric bill, cell phone, rent, groceries, entertainment, shopping, gas, et cetera. In the modern economy there is literally no vendor who cannot take a credit card (even a roadside hot dog salesperson can process a credit card transaction with their smartphone), and today's society prefers it. "Cashless" transactions are the new normal. This strategy involves assigning certain expenses to specific cards. Each credit card will be assigned bills to pay; the highest bills should be assigned to the credit card with the highest credit limit (for example, your mortgage/rent should be paid by your credit card with the highest credit limit as well as your car payments, since these are typically your greatest expenses) After your housing and transportation expenses are paid, the next highest bills tend to be insurance and utilities. Assign these bills to the next highest limit credit card. And, so on... When using this strategy, it's important that you don't exceed the amount of credit granted on your credit line. So, when arranging expenses on the cards it is important to match the credit line with the total amount you will be charging to the card.

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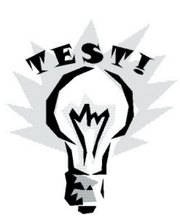
3. Too much credit could be harmful if you do not have the income to sustain it. In this chapter it has already been recommended to have between 2 - 5 credit cards, ideally your credit should be able to cover your bills 1.5 (one-and-a-half) times (minimum available credit). That means that your total monthly budget will be completely covered with the amount of credit you have on your credit cards. The extra credit left over on your card is not extra money; it is there for **emergencies**. It's easy to drown in debt if you don't have the ability to pay for it. The biggest temptation in society today is to buy now and pay later. We live in a culture that prizes instant gratification. If you're not disciplined, the situation can easily cripple your life just like it did to Rachel.



The goal here is for you to rule your finances rather than your finances ruling you. Millions of Americans subscribe to the idea that credit is extra money and does not have to be paid back. Credit is <u>*NOT EXTRA MONEY!*</u> It **must** be paid back. You should always pay your bills every month (on time and in full) and be responsible with your money and the money of others (creditors/credit cards).

INSTRUCTOR TALKING POINT

This is one of the most important things to remember about Credit Cards, so it bears repeating: This is NOT FREE MONEY! Your credit card bill can work for you to help build your credit, but it MUST be paid back ON TIME and IN FULL. EVERY MONTH. Money borrowed from credit cards is other people's money (OPM). Never consider that credit is extra, free money for you to do what you want with. Credit and credit cards should be managed with the upmost care, if not then you are asking to have major problems with debt. Remember you live within a budget and your credit exists within your budget, it does not expand the amount of money you can spend in a month.

For Example: [WRITE THE FOLLOWING ON THE BOARD]

You earn $1,200 a month and you have a $1,500 credit limit, you pay the following on your credit card:
$200 on groceries
$120 on gas
$180 on utilities
$600 on rent
$100 on your phone bill
$1,200 TOTAL

How much money do you now have to use on the credit card? The answer is ZERO DOLLARS. You've already spent your money. You can no longer afford to do anything else if you're managing your money and OPM wisely.

We need to discipline our minds to accept the fact that no matter what we spend on our credit card, we must maintain the ability to pay it off within the grace period (at least 21 days – on time and in full). If we don't, we fall victim to the biggest detriment in the world of debt: interest. Interest is calculated on the daily average balance, and if it's not carefully controlled it will control you. This rule is not negotiable: do not charge expenses on your credit cards that exceed your income. Always know this: You are borrowing this money just the same as if you got a loan at the bank (only with much worse terms). It needs to be paid back. If you don't pay it back on time and in full, this interest will slap you in the face. At this point, your sense of discipline is going to determine if you can be successful in building or rebuilding your credit or if you end up like Becky, backed into a corner and unable to see a way out.

One of the biggest dangers of using a credit card is the temptation to overuse it. Remember when we talked about impulse spending? The danger to your budget when you don't account for things like nibblers and bouncers is great. The danger with credit cards can be even more. It can FEEL like you have a lot of money in your pocket just because you might have a high spending limit. You don't. Realistically, and what you need to keep in mind, is that you don't have any more money than you normally would. You just have the ability to pay your bills differently. The credit card company wants you to fall into this trap. Will they allow you to pay less than the full amount due each month? They will be extremely happy to let you go right along paying interest-only payments and carrying that balance from month to month to month. That's how they make most of their money from the consumer. In other words, a customer who pays his bills on time but only in the minimum installments is a dream customer for the credit card companies.

Your goal is very different from that of the credit card companies. Your goal here should be to use your plastic to earn yourself interest on your own money and to increase your credit score. Your goal is NOT to let debt build up and never go away.

Of the twenty most common bad habits with money, almost half of them have to do with credit cards: Carrying a credit-card balance month-to-month; Being reckless with your personal information (giving out your Social Security number without having confirmed that it is absolutely necessary); Making late payments; Not knowing your credit score; Trying to keep up with the Joneses when you can't afford to; Living beyond your means; and Impulse shopping.

So, you need to be honest with yourself. Are you an impulse shopper? If so, you're going to need to do some serious work on your self-control and discipline. If you can't do that, then credit cards might always be a danger for you.

Remember our second Taco Bell job? If we wanted to calculate the minimum available credit we would need, we would:

Take our total monthly expenses ($1,390.00) and multiply it by 1.5.

1,390.00 X 1.5 = 2,085.00

$2,085.00, therefore, is the minimum available credit that we are looking for. Is this always realistic? Maybe not, but it's a goal. This calculation gives us our target number.

Job #2		
$8.25 per hour		
48 hrs/ Weekly Income		$396.00
(times 4.33)		
Monthly Income		$1,714.68
Less Withholding 15%		($257.20)
Mow 3 lawns on day off at $40 per lawn		($120)
Net Pay $1,577.48		
	Expenses:	
31.7%	Rent	($500)
15.8%	Food	($250)
6.4%	Clothing	($100)
15.2%	Savings	($240)
11.4%	Utilities	($180)
5%	Probation	($80)
2.5%	Transport	($40)
12%	Discretionary	($187.48)
100%	Total	($1,577.48)

Expense Tracking

Use the primary credit card for everything you buy. This will allow you to track how much you spend on each category of your life, both monthly and annually. This will also help with money management, budgeting, and tax preparation. (Note: this only works if you use one primary credit card.) American Express, Visa, and MasterCard have a feature that is really great. Each card has a different name for the feature but basically it allows the cardholder to receive an annual expense statement. This annual statement breaks down by category how the cardholder spent money all year. You can use the annual expense statement to see how much you spent on gas, groceries, cell phone, restaurants, movies, et cetera...

This is a great tool for budgeting because you no longer have to guess how much you spend; the actual data is in your hands. American Express provides the annual expense statement automatically and the cost is included in the card's annual fee. With Visa and MasterCard, the cardholder has to request the annual expense statement and they usually charge you for it (around $10 - $20).

INSTRUCTOR TALKING POINT

Taxes get a whole lot easier when you can break down your entire year's expenditures by how much you spent on gas, groceries, rent, etc... If you don't do your own taxes, you're making it cheaper to get your taxes done by someone else simply because they won't spend hours upon hours sifting through your shoeboxes of receipts.

Earn Interest for up to 29 Days

Instead of paying all of your expenses in cash, utilize your credit card to pay your expenses while living within or below your means. When you use your credit card instead of cash you allow your money to sit in the bank and earn interest. You also allow yourself to utilize a higher percentage of your credit limit, in the future (6 months) you will be able to ask for a higher credit limit (by increasing your credit limit you increase your credit score - remember our goal for available credit). During the month, instead of just spending money to pay off your bills you have allowed your money to earn interest in the bank, and you've also utilized your credit to increase your credit score. Why wouldn't you want to use your monthly bills to help you make more money and build credit?

Money Saver! Put your money in an interest bearing account and pay your bills with a credit card!!!

Once again, this strategy requires discipline! You must never charge on your credit card more than you can pay off in full by the end of the month. If you are budgeting and planning, then this credit card strategy works and makes you money.

Remember! Grace Periods On Credit Cards Apply Only To People Who *Don't Carry A Balance*!

"If you pay the full amount you owe on your card each month, you are basically enjoying an interest-free loan from the bank. But card users often don't realize that if they are carrying any balance at the end of the month, the card issuer will charge you interest starting from the day you borrowed the money," says Megan Bramlette, managing associate at Auriemma Consulting Group, which consults with banks. If you allow your balance to roll from one month to the next on a credit card you are not going to receive a grace period to pay your bills. You certainly are helping the Credit Card companies, though.

"Acing" Your Credit Report Card

All of your credit history is reported on your credit report; it is your "credit report card." If you have been responsible and disciplined you will find yourself with all A's on your report card. However, if you have mismanaged your credit you will find horrible grades. Your credit grades are based off of the information in your report, in industry terms you will receive a credit score. Credit scores range from 350-850. There are three major credit bureaus: TransUnion, Experian, and Equifax. These three credit bureaus collect all of your credit information, the most important parts of building credit are your payment histories, length of credit history, income, available credit, amount owned, and debt-to-income ratio. When you effectively manage your credit you build your history of being responsible and that can be viewed by creditors on your credit report.

INSTRUCTOR TALKING POINT

Your credit score in the world of credit is the equivalent of your ID in the real world, it consists of three digits that are so crucial that without them you will never be taken seriously. The reality this: the higher the score, the stronger you are (financially speaking). That score, known as the FICO score, could be as low as 350 and as high as 850. Your FICO score works much like your report card in school; you get perceived differently as an A student than you would as an F student.

Did you know that every time you pay your credit card bill you increase your credit score? It's true. Out of all areas that impact your credit score, payment history has the greatest effect. It is essential to make sure you pay on-time and in full. Not only does paying on-time and in full help you to create a positive payment history, it also helps you keep the amount of available credit high.

Credit Score Grades

- 760-850 Excellent Credit (A)
- 690-759 Good Credit (B)
- 630-689 Average Credit (C)
- 560-629 Poor Credit (D)
- 350-559 Bad Credit (F)

Job #1		
$8.25 per hour		
40 hrs/ Weekly Income		$330.00
(times 4.33)		
Monthly Income		$1,428.90
Less Withholding 15%		($214.34)
Net Pay $1,214.56		
Expenses:		
41.2%	Rent	($500)
20.5%	Food	($250)
6.2%	Clothing	($75)
7.4%	Savings	($90)
10.3%	Utilities	($125)
6.6%	Probation	($80)
3.3%	Transport	($40)
4.5%	Discretionary	($54.56)
100%	Total	($1,214.56)

<u>**Your Strategy**</u>: Pay your bills on time and in full; manage your debt-to-income ratio. Immediately upon your release from prison you may be at a high debt-to-income ratio (70% or greater). After you have established yourself outside of prison and are no longer underwater with all of your bills, you should aim to have a much lower debt-to-income ratio (45%). A 45% debt-to-income ratio is a "golden number" within the financial world, it is a great goal; however, reality is much harsher than this ideal. You should try to get as close to the 45% as possible, some months you may be at an 80% debt-to-income ratio, others at a 50% debt-to-income ratio, manage your finances to keep this number low and in a good range of 45-60%.

How to calculate your debt to income ratio
How do we figure out this debt-to-income ratio? There is a very simple equation:

ALL YOUR MONTHLY EXPENSES/MONTHLY INCOME

FOR EXAMPLE:
Expenses: Rent $500, Utilities $125, Food $250, Misc. $195 = Total $1,070
(Everything except savings and discretionary in our Taco Bell example)
Income: Job 1: $1,214.56/month

Debt to Income = $1,070/$1,214.56 = 88%

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EXAMPLE #2:
Expenses: Rent $500, Utilities $180, Food $250, Misc. $220 = Total $1,150
(Everything but Savings & Discretionary in our 2nd Taco Bell example)
Income: Job 2: $1,577.48/month (full time $8.25/hr working 40hrs/week, 15% taxes; Second job mowing lawns: $120/month

Debt to Income = $1,150/$1,577.48 = 73%

A Debt to Income ratio of 45% with an income of $1,577.48 would be $709.87. Can you realistically limit your expenses to such a low number? It would be *very* difficult. If you can't lower your expenses, then you should raise your income. The point here is to use 45% as your benchmark. Again, sometimes that may be out of reach, but that is the goal to reach for.

Part of your credit score derives from your outstanding revolving credit balance (the amount of credit you continually use) and your payment history. If your total expenses each month are $1,150, and you pay it on time and in full each month, you will have $1,150 average revolving balances and have moved $13,800 through your credit system annually. Payments, on time and in full, will help your credit rating. Late payments or partial payments will damage your score. Do not use credit cards to pay your expenses every month if you cannot pay your credit card back on time and in full!

Job #2		
$8.25 per hour		
48 hrs/ Weekly Income		$396.00
(times 4.33)		
Monthly Income		$1,714.68
Less Withholding 15%		($257.20)
Mow 3 lawns on day off at $40 per lawn		($120)
Net Pay $1,577.48		
Expenses:		
31.7%	Rent	($500)
15.8%	Food	($250)
6.4%	Clothing	($100)
15.2%	Savings	($240)
11.4%	Utilities	($180)
5%	Probation	($80)
2.5%	Transport	($40)
12%	Discretionary	($187.48)
100%	Total	($1,577.48)

Build Your Available Credit

In our previous example of $1,150 per month, you revolved $13,800 through your credit system in one full year. On time payments, in full, will cause the credit card company to increase your available credit limit. As that number rises, other credit issuing companies will offer you more credit as well. It is important to remember that as you move balances through your credit card you must pay off that balance completely. Available credit is essential when building your credit score; maximize your credit score by paying off your credit card balance each month in full. You will benefit from utilizing your credit card to pay expenses by building a history of consistent payments and credit utilization. The history you build with your payments and credit utilization allow you to negotiate with your credit card issuer every 6 months for more available credit.

INSTRUCTOR TALKING POINT

It is very important to maximize available credit on your card as it demonstrates a strong management of your finances. It demonstrates a sense of discipline and, most importantly, it increases your credit score. If you don't have available credit on your card it demonstrates weakness, a lack of discipline, and it is what bankers call a choke. Most importantly, it DECREASES YOUR CREDIT SCORE.

If you have been issued a credit card with a limit of $1,000 and you spend $500, you have decreased the amount of available credit, and unless you pay off the entire balance, you will not maximize your credit score. That's why it is essential to pay your bills in full. In the future, you can ask for more available credit if you continue to pay off your balance each month. Your payments provide a justification to ask the credit card companies for a higher credit limit by proving that you have been responsible with what has already been given to you.

Note: You have to be aware of your own income and expenses, do not get caught in the trap of thinking that just because you have a higher credit limit you can spend up to that limit. You must remain responsible and continue your financial discipline by sticking to your budget and living within your means.

Be careful, too much revolving credit, used and unused, will damage your score. The danger of using more credit than you can pay off in a month will lead you down the accelerated path towards debt.

INSTRUCTOR TALKING POINT

When it comes to reading your credit report, it consists of two crucial letters: an "I" for Installment and an "R" for Revolving. An installment is typically a fixed sum of money, known as debt service, that you're obligated to pay every month. This will typically consist of a mortgage payment, a home equity line of credit, or a car payment. These payments are always the same every month. They do not change.

The R is for revolving, and that consists of a fluctuating monthly payment such as your credit cards or any type of furniture or appliance loans. The way the I's and R's are regulated by the credit bureaus are by a series of numbers from 1 to 9. With a 1 being a perfect payment history and a 9 being a terrible payment history.

Large Purchases

Having large sums of cash readily available is not safe nor is it good money management. All your extra money should be in a bank account earning interest, not sitting in your pocket doing nothing. A credit card allows you to make large purchases without hassle. A key to wealth is making your money earn money for you, if you are constantly using your money before it has a chance to accrue interest then you are missing out on the power of saving your money. Why not borrow other people's 'buying power' and let *your* money earn interest?

Sometimes it is not reasonable to purchase items with cash or money outright. Credit is needed for some things such as a home (mortgage) and a car (auto loan). The majority of Americans cannot afford to buy those items outright, nor can they afford to buy them on a credit card, but a credit card can put you on the path to get approved for the amount of credit needed for those items. Credit can eventually allow you to purchase the home, the car, and the equipment that are needed for your own financial goals and own a piece of the American dream.

INSTRUCTOR TALKING POINT

Making large purchases on a credit card is easier to do than getting a loan, but unless you have the money to pay for that large purchase already sitting in the bank, DON'T DO IT! Many people have heard of friends or acquaintances buying automobiles and extravagant things on credit cards, but typically they've already saved all the money in advance to pay off the bill in full at the end of the month. AGAIN, if you don't have the money sitting in the bank to pay off the loan, DON'T DO IT!

Emergencies

Obviously, if you have an emergency and need to pay for necessities or repairs, a credit card allows you to handle the financial part of the emergency more efficiently. If you operate with only cash, you might find yourself in a situation where you have no safety net to help you through a tough time. Credit allows you to move through problems without panic, but as always, you should remember that the credit you use to solve a problem or emergency *must* be paid back.

INSTRUCTOR TALKING POINT

One of the most convenient things about a credit card is that it allows you to have immediate purchasing power should a crisis occur. Sometimes, you don't have the ability to get to the bank and obtain cash to pay for something. Credit cards are accepted everywhere (VISA: It's everwhere you want to be!). A credit card will also allow you to immediately fix a problem even if you don't have the cash for it. If you do use more credit than you have in the bank to pay for, you should try to pay it off as soon as possible so you don't end up paying too much in interest. Remember that any time you carry a balance from one month to the next, you will be hit with interest (Yes, believe it or not, calculated backward from the date of the purchase).

Bad Uses of Credit Cards

Before we leave our discussion of credit and credit cards, it's important to review the bad ways to use a credit card. We have already discussed that allowing a balance to remain on your card for over a month is a horrible way to use a credit card. There are also several other ways you should *not* use a credit card. Some horrible uses of a credit card are:

- **Debt transfers**
- **Cash advances**
- **Impulse Purchases**

Debt Transfers

Moving the balance owed on one credit card to another credit card is immediately identified on the credit reports that are pulled by financial institutions. The debt transfer can also overlap by 12 - 24 hours and often counts twice towards your 'credit drawn balance.' There may also be higher interest rates for debt transfers on some cards as well as fees for making a debt transfer. Credit card companies and financial institutions use computer data modeling that operates in real time so lenders can see you transferring debt, and a debt transfer is *always* a red flag and liable to hurt you. Multiple debt transfers will cause financial institutions to think you're not able to pay your debts, and they may deny you future credit. A simple solution for debt transfers is **not to do them** and try to resolve any outstanding balances either through your own financial planning or through talking with your creditors.

INSTRUCTOR TALKING POINT

NEVER do a debt transfer (balance transfer)... unless you really, really have to. So what qualifies as a "really, really have to" moment? Well, if you have a large balance on a card with a high interest rate, and there's no way in the immediate future to pay it off, you might want to consider moving the balance of one credit card to another. How do you do this? You pay off one credit card with another (and, yes, a credit card company will accept that as a good payment). If you use this option, you also need to be very aware of the interest rates and terms of both companies. It does you no good to end up with a higher interest payment.

However, you typically get hit with penalties or fees because of it. So before you do a balance transfer it's best to read the fine print of your credit card contract. In addition, if you do balance transfers frequently you'll raise an immediate red flag at both credit card companies you're using, and they may end up reducing the amount of available credit, increasing your interest rate, or denying you credit in the future. It also shows up immediately on your credit report, which can be viewed by anyone else checking your credit. To be safe, remember that a debt transfer is NEVER something you want to do on a whim. Doing it often is a surefire way to make your credit worthiness plunge.

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Cash Advance

This is a strong statement, but heed the advice! **Do not <u>EVER</u> get a cash advance from a credit card, under <u>any</u> circumstances**. There's a difference in the way credit card companies process cash advances versus regular purchases. Cash advances incur finance and interest charges *immediately*. That means you are paying both of those costs *starting from the day you advance the cash*. In contrast, when you buy something on credit, the payment grace period of 21 - 30 days gives you some time before you get hit with those costs. If you need to have cash, go to the bank and withdraw it either from the teller or the ATM. Why would you pay up to 18% interest, and finance charges to borrow *your own* cash from a credit card cash advance? It makes no financial sense.

INSTRUCTOR TALKING POINT

Simply put, don't get a cash advance on your credit card. **Ever**. Ever been to Wal-Mart to get some groceries? When you reach the end of the checkout process, you swipe your card in the little box, and the machine very nicely asks if you would like some cash back with that. $5? $10? $20? If you start thinking about how you need to stop at the gas station on the way back and might want to pick up some gum or some Gatorade, or maybe you need some cash to give your kids their allowance when you get home, you might end up getting $5 or $10 back. Convenient, isn't it? Congratulations, you just got a cash advance, and you're paying interest on it from the moment you press the button for yes. Not 21 days later, not at the end of the billing period, *that day*.

Let's say you bought $127 worth of groceries and then decided to get a $5 cash advance. It's only $5, right? The interest on $5 might not seem like all that much. Even just a $5 advance will cost you $0.0025 in interest. Per day. Until you pay it off. If you wait until the end of the month when you get your bill, you could be looking at an extra $0.07 (plus the $5 you took out) out of your pocket just for that convenience. Not much, right?

It gets worse. Unfortunately, the credit card company combines your advance with the purchase. Congratulations, again! Instead of a $5 cash advance (and a $0.07 payment at the end of the month), you just got a **$132 cash advance**! Remember that $0.0025 daily interest you were paying for your "5 dollar" advance? You're actually paying $0.066 in interest for that cash advance now. Per day. Until you pay it off. If you don't think about that until you get the bill at the end of the month, you could be looking at an extra $1.98 in interest added to your credit card bill. Sneaky, isn't it? Well, that's business, and you agreed to it when you signed the contract.

It might not seem like $2 is much extra to pay, but that's $2 out of your pocket. If you're counting every penny, that $2 can add up. Remember our first Taco Bell budget? We had $23.65 in walking around money. If that's *my* discretionary income, I need every cent of it. Or, if you think of it another way, would you donate $2 to the credit card company just to be able to do something you should be able to do for free? Now imagine doing that every time you stop at the checkout counter? Do that four or five times a month and you just racked up almost $10.00 in extra interest payments. Do NOT get cash back at the register. It's the WORST thing you can do. That daily interest is simply unmanageable and can easily sink you and your budget. Go to your bank's ATM if you need cash so that you don't end up costing yourself any extra money.

By the way, the checks that the credit card company sends in your statement are cash advance instruments designed to make you think they are harmless bank checks. Tear them up immediately – do not throw them away – **tear them up and throw them in the fireplace**. Not only do you often have to pay interest and finance charges on them immediately; additionally, they are excellent targets for identity thieves who can easily dig your statement out of the garbage, scan, edit, and print the torn up checks and use them. Call or write to your credit card company and request that they never send you cash advance checks.

INSTRUCTOR TALKING POINT

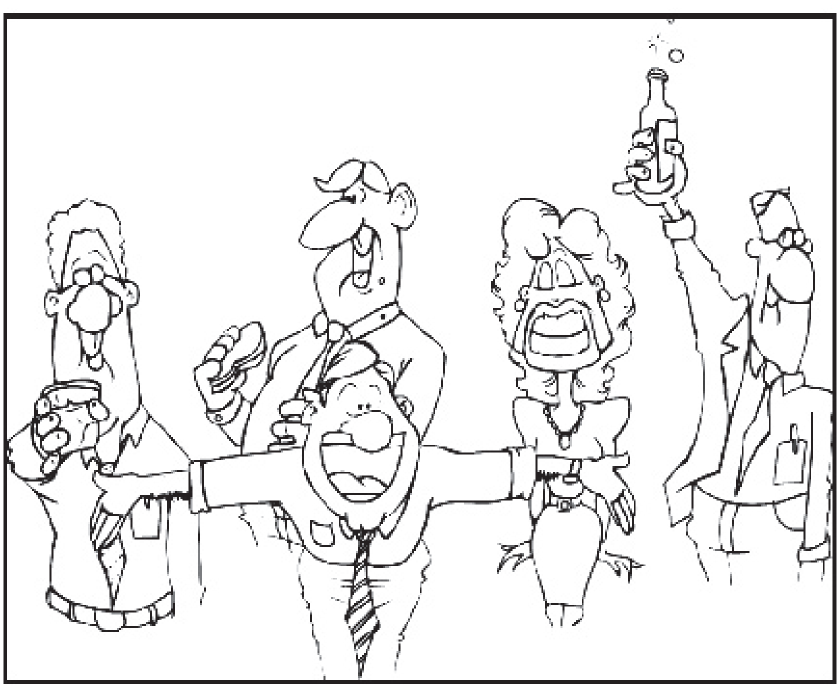
Do not be indecisive when considering dealing with the company who sent you the cash advance checks. Call them immediately and let them know, very sternly, that if they ever do it again you are no longer going to be a customer. It's that serious. Make sure while you're on the phone that they make a notation on your account to never send you cash advance checks. If you can't talk to a person on the phone to explain how you detest cash advance checks, write them a letter explaining your position, immediately.

Impulse Purchases

We've all done it. You are at the mall, or Best Buy, or Wal-Mart; and something you didn't intend to buy before seeing it catches your eye - a video game, the latest Selena Gomez album, a car accessory, or a gift for that birthday coming up. It is okay to buy these types of items *if you have budgeted for them*, but not on impulse – not on credit. Impulse purchases add up very quickly, they typically lead to regret, and are fully consumed by the time the payment is due. Always remember that your credit is **NOT** your money and it can be very costly to use without consideration. The best thing to do when you have a strong urge to buy something immediately is to simply walk away, wait 48 hours and then reconsider buying the item.

INSTRUCTOR TALKING POINT

We've talked about this before, but we keep coming back to it because it is extremely important. You NEED to have the discipline to control your spending. If you have trouble with impulse purchases or controlling yourself with a credit card, then you don't need to use a credit card. It's as simple as that. If your spouse can't control their spending habits, then they don't need to have a credit card. That might not make you popular with the wife, but it's a conversation you need to sit down and have. Impulse purchases *can* be part of a budget *if* you account for them in your discretionary spending. Remember that a budget is essential to obtaining wealth, and credit exists *within* a budget not in addition to it. Without sacrificing our need for immediate gratification, long-term financial goals will never be obtained. Sacrifice a little joy today for prolonged happiness tomorrow.



Have you ever heard the expression: 'Got money, got friends'? You may know the scene. You're the life of the party! You give the bartender your credit card, keep an open tab, and here come your "friends", maybe some girls. After a few drinks, you casually buy them a round of drinks, and everyone's happy. There's music, dancing, everyone's having a good time. And, you completely forget about that bar tab until the bill arrives. The trouble is twofold: 1.) your friends end up looking at you crazy when you mention buying them drinks because they were probably drunk and 2.)You will not remember because you were drunk too. A bar tab is actually a very typical impluse buy. Bar tabs only lead to less money and more headaches. Don't use your credit card for a bar tab; better yet don't develop a bar tab.

Most Expensive Debt

Do not ever use a credit card to make a major purchase that you don't have the money to cover in 30 days. It is *the most expensive* way to borrow money. Let's consider Larry Coffee. He's had a pretty successful business going for the past two years as a cotton candy vendor in Tampa, Florida. He's doing well, but he still needs to be careful with his budget. One particular customer, a nice young woman with Buccaneer season tickets, really caught his eye. Every time she saw Larry in his jester costume selling his cotton candy, she greeted him with a smile and stopped to chat. By December, they were meeting outside his work for coffee and a few dinners. By the start of the next season, they were officially together. After the second year of dating, Larry took a day off from selling cotton candy and proposed to her right there in Raymond James Stadium with a beautiful engagement ring.

Larry, unfortunately, couldn't afford the engagement ring. $4,995.00 was just a bit too steep for his finances. But, Larry had good credit. No problem. He put the engagement ring on his credit card! Larry could have secured a bank loan, but he was in a hurry and didn't want the hassle. Let's look at what this cost him:

Item Purchased: Diamond Engagement Ring: $4,995.00									
Loan Comparison									
Credit Card					Bank Loan				
Application Fee:		$0.00			Application Fee:		$50.00		
Interest Rate:		14.5%			Interest Rate:		8.00%		
	Starting Balance	Interest	Payment	Ending Balance		Starting Balance	Interest	Payment	Ending Balance
January	$4,995.00	$60.36	$171.93	$4,883.43		$5,045.00	$33.63	$158.09	$4,920.54
February	4,883.00	59.01	171.93	4,770.50		4,920.54	32.80	158.09	4,795.26
March	4,770.50	57.64	171.93	4,656.22		4,795.26	31.97	158.09	4,669.14
April	4,656.22	56.26	171.93	4,540.55		4,669.14	31.13	158.09	4,542.17
May	4,540.55	54.86	171.93	4,423.49		4,542.17	30.28	158.09	4,414.36
June	4,423.49	53.45	171.93	4,305.01		4,414.36	29.43	158.09	4,285.70
July	4,305.01	52.02	171.93	4,185.09		4,285.70	28.57	158.09	4,156.18
August	4,185.09	50.57	171.93	4,063.73		4,156.18	27.71	158.09	4,025.80
September	4,063.73	49.10	171.93	3,940.91		4,025.80	26.84	158.09	3,894.55
October	3,940.91	47.62	171.93	3,816.60		3,894.55	25.96	158.09	3,762.42
November	3,816.60	46.12	171.93	3,690.78		3,762.42	25.08	158.09	3,629.42
December	3,690.78	44.60	171.93	3,563.45		3,629.42	24.20	158.09	3,495.52
Second Year						Second Year			
Starting Balance			3,563.45			Starting Balance			3,495.52
Total Interest Paid in Second Year			409.68			Total Interest Paid in Second Year			219.00
Total Payments made in Second Year			2,063.16			Total Payments Made in Second Year			1,897.08
Ending Balance			1,909.96			Ending Balance			1,817.44
Third Year						Third Year			
Starting Balance			1,909.96			Starting Balance			1,817.44
Total Interest Paid in Third Year			153.29			Total Interest Paid in Third Year			79.64
Total Payments made in Third Year			2,063.25			Total Payments Made in Third Year			1,897.08
Ending Balance			0.00			Ending Balance			0.00
Total Cost with Credit Card:			$6,189.57			Total Cost with Bank Loan			$5,691.24
Loan Cost difference:									$498.33

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You may not think that $498.33 seems like an enormous amount of money, and you're correct. But, would you be willing to save that much for one hour of your time? That's $498.33 that could have been earning Mr. Coffee money over those three years if he'd put it in a savings account or invested it.

Excessive or unmanaged debt is a hindrance to building wealth!

INSTRUCTOR TALKING POINT

[STORY]:**Kamikaze and Commitment**

In Japan, there is an ancient legend of the "Divine Wind" which was brought forth from the prayers of the Japanese to protect them from the hordes of Kubla Khan who were sailing from China to invade Japan. The Japanese saw the fleet of ships and prayed for deliverance; their prayers were answered when a typhoon hit and wiped out the Khan's entire fleet. "Divine Wind" in Japanese is "Kamikaze."

In World War II, the Japanese brought back the idea of Kamikaze, but they did it by using their own soldiers as sacrifices to save the nation from the approaching fleet of the U.S. The Japanese pilots would man planes that had been stripped of everything but fuel and explosives to become "flying bombs" which they would fly straight into U.S. ships.

Years after World War II, a magazine reporter found a kamikaze pilot who said he had flown over 22 Kamikaze missions... Let me say that again: 22 *Kamikaze* missions... How is that possible? Well, when asked, the pilot said that he wanted to be successful and prayed for it, but he just wasn't committed.

You *must* have success in mind as well as commitment. If you can't follow through with your plans by sticking to them, you are not going to become debt-free. To become 100% debt-free you will have to make some sacrifices and face some hardships. There's no way to sugar-coat this. It *will* be difficult, but it is not something you'll lose your life over. In fact, once you're debt-free you'll gain so much more, the peace of mind that you owe *nothing* to *anyone*.

INSTRUCTOR NOTE

It will help to drive home the point about good and bad debt if you write this math out on the board. It may also help to give some examples of good and bad debt. Season tickets, credit at the casino, a car: would they be considered good or bad debt? Allow for duscussion here.

Why? Let's do the math. If you have $10,000 in a savings account earning 4%, your money will earn $400 in interest in one year. If you have $10,000 in debt on a credit card you will typically pay 12% - 18% interest per year, let's say it's 12%. 12% interest on $10,000 debt means you pay $1,200 interest in one year. In other words, at the end of one year your $10,000 in savings is worth $10,400, but your $10,000 in debt is now $11,200. The result is that you are now $800 further in the hole.

With that understanding let's put another foundational block in place.

Money Saver! Debt is a good thing if you use the borrowed money to earn a higher return than the debt interest payment. Debt is a bad thing if you use the borrowed money to earn a lower interest return than the debt interest payment.

Let's demonstrate with math again. You borrow $10,000 at an interest rate of 8%. At the end of one year you need to pay back the $10,000 plus $800 in interest for a total of $10,800. When you borrow the money, you invest it in an asset that grows 12% in one year. 12% interest on $10,000 is $1,200, so at the end of one year your $10,000 is worth $11,200. You take the $11,200 and pay off the debt of $10,800 and you are ahead by $400.

This foundational block is worth stating again. Debt is a *good thing* if you use the borrowed money to earn a higher return than the debt interest payment. However, debt is a bad thing if you use the borrowed money to earn a lower interest rate than the debt interest payment or consume whatever it is you borrowed the money to buy, such as a vacation, holiday gifts, clothes, or meals.

With that foundational block in place, and a clear understanding of the math involved, it's easy to understand why it's important to get out of debt. This especially applies to any debt that is on a credit card with interest rates of 12% or more, because that is well above any interest rate your money is likely to earn in savings.

But, what if you do have some unmanageable debt? Maybe, like most people, you've gotten yourself into a corner without even realizing it. Remember Rachel? She wanted to maintain a lifestyle that was unrealistic for the income she was bringing in. Let's talk about some ways to get back out of that corner, some debt strategies, without resorting to the means that Rachel used and ending up back in serious trouble. In order to effectively use the strategies we'll be talking about, you need to accept the two following principles:

1. Once you have eliminated/paid off your existing debt, you will not run out and immediately charge up more debt. If you are going to incur more debt, then the benefit of eliminating debt to help build wealth is lost.

INSTRUCTOR TALKING POINT

If you have a problem with self-control or managing your finances, you don't need any more credit. You need help. If you can't avoid impulse purchases or you don't have the personal fortitude to stick to your budget, then you will never get out of debt. You have to stick to the plan of staying out of debt once you are debt-free.

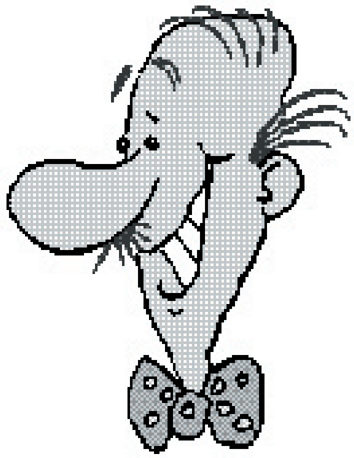
If staying debt-free meant you had to spend 5 years driving a used car from the 1990's would you do it? If you had to limit the amount of meals you ate at restaurants would you do that? What if it meant that you could only get public access channels for 5 years or that you had to buy some of your clothes at Goodwill or Salvation Army?

These are the sacrifices you have to make to get out of debt and possibly stay out of debt. If you are really serious about your success in becoming debt-free, realize that the commitment is very tough. But, it is worth the price.

2. You will be disciplined in attacking your debt. Eliminating debt will take time, patience, dedication, and most of all, it will take sacrifice. It takes financial maturity to eliminate debt. If you are not mature enough financially then there's no point in putting yourself through the task.

Debt Strategies

The Debt Eliminator



Meet Floyd. He's got a pretty good job, been working at Tallahassee Auto Mart for a year and a half and has advanced to a supervisor's position earning $13.15/hr. His net pay every month is $1,936.81. Using his budget, he accounts for his rent, food, utilities, and all the necessities. However, Floyd wasn't always so disciplined. When he was first starting out, Floyd didn't know how to use credit cards the right way, and he ended up with a stack of debt. His income is still able to deal with making the minimum payments (barely), but he feels like he's slowly sinking under all this debt. Penny's, Wal-Mart, Visa AND MasterCard. That's not to mention his auto loan. All these things added up on him a little at a time, but when he sat down to add it all up, Floyd almost had a heart attack. He's over $23,000 in debt!

Unfortunately, Floyd is an average American. He doesn't think about the debt he's building up; he's just an avid consumer. So, how does he get himself out of the hole he's dug himself into?

First, Floyd needs to sit down and list all of his debts in order from the smallest payoff balance to the largest pay-off balance. He isn't concerned with interest rates, or terms, unless two debts have similar payoffs. In that case, he lists the higher interest rate debt first. Next to the "payoff amount" on each debt, he now writes down the "minimum payment" he has to make each month as required by the creditor. Next to the minimum payment column, he lists his "new payment". This represents the amount of money he's going to send to the next creditor on his list once he's paid off the previous creditor. The "payments remaining" column is where he notes how many additional payments he has to make to eliminate the debt entirely from his list.

Item	Payoff Balance	Minimum Payment	New Payment	Payments Remaining	Cumulative Payments
Penny's	$300.00	$20.00	-	18	18
Wal-Mart	$650.00	$25.00	$45.00	6	24
Sears	$1,200.00	$33.33	$78.33	11	35
Visa	$2,500.00	$69.44	$147.77	9	44
MasterCard	$5,000.00	$138.89	$286.66	6	50
GMAC	$14,263.68	$314.72	$601.38	18	68
Total Payments	$23,913.68	$601.38			

* Note that each of these accounts is charged interest, making the payoff balance greater than the total amount that is actually shown. Interest charged in the following amounts:
Penny's 21% (total amount of interest charged: $51.07)
Wal-Mart 21% (total amount of interest charged: $164.00)
Sears 21% (total amount of interest charged: $519.90)
Visa 15.9% (total amount of interest charged: $1,313.72)
MasterCard 9.9% (total amount of interest charged: $2,846.11)
GMAC 7.9% (total amount of interest charged: $12,143.63)

Total interest paid over the total 68 months: $17,038.43)

INSTRUCTOR NOTE

Write the above example on the board and, eventually, the math for the DPR strategy as well.

Finally, Floyd is going to list his "cumulative payments" or the total payments needed (including the eliminator payment) to pay off that debt. In other words, this is the running total for "payments remaining." Each time Floyd eliminates a debt, he'll write a new list so that he can see how close he is getting to being debt free. Paying the little debts first gives a quicker result. It's motivating, and you are more likely to stay with the plan if you see benefits early on. Imagine how good it will feel when Floyd's list goes from six creditors to five, then to four…

Here's how it works. Using the example above, your minimum payment total for your debts is $601.38. Here's the discipline part, you have to commit to paying $601.38 every month until all the debt is eliminated. After 18 months you will have eliminated the Penny's debt of $20 per month. Most people would take that $20 the following month and spend it on nibblers. **Pizza party!**

Not with the eliminator! You are going to apply that $20 to the Wal-Mart payment and pay Wal-Mart $45 each month instead of the minimum of $25. After 6 payments to Wal-Mart of the new $45 amount, you will eliminate the Wal-Mart debt in just six months. With Wal-Mart eliminated, you take the $45 you were paying them and apply it to your Sears payment and pay $78.33 per month instead of the minimum of $33.33 they require. In 68 months you will have eliminated all of your debts. It takes discipline! That's nearly six years of not using your credit cards to rack up more debt, following a budget, and continuing to apply $601.38 to your bills every month for 68 straight months. It takes a lot of maturity, but the end result is no more debt building at 8-21%. At the end of those 68 months, you (and Floyd) are now debt free.

INSTRUCTOR TALKING POINT

Let's look at these numbers. Putting aside his car loan, Floyd has built up $9,650.00 in credit card debt. Does that seem excessive? Believe it or not, the average American has around $15,607.00 in credit card debt (as of 2014. This number has gone up since then, usually at a rate of about 2.5% per year), so Floyd is a little on the low side. He's looking at paying only $601.38 for 68 months to become completely debt-free. Exactly how long is that? 5 years, 8 months. Almost six years of paying $601.38 every month. Does that sound possible? Could you do it? It's a long time to deal with it, but once you have dealt with it you will owe nothing to anyone.

Let's see what you've learned from this class and the foundational blocks you have put in place. The question now is what do you do with the $601.38 the month after you've eliminated all of your debts? The answer is: you invest it!

In our example Floyd had $23,913.28 in debt (add up all the balances). The interest rates of your debts range from 7.9% to a whopping 21%. The average of the six creditors that he owed is 16% interest. Carrying $23,913.28 in debt, at an average rate of 16%, means he was incurring interest for one year of $3,826.12. Put another way, Floyd went $3.826.12 deeper into the debt hole every single year! That's exactly how things pile up and turn into a sea of debt. Before he knew it, Floyd felt like that sea would drown him.

By applying discipline, patience, and financial maturity, Floyd worked hard and eliminated his debt. Now, he invests the $601.38 each month into a good growth mutual fund.

At the end of one year, he has $601.38 x 12 = $7,216.56 invested. Assuming a growth rate of 8% on his investment means Floyd's investment money earned $577.32. Put another way, he eliminated the $3,826.12 going out of his wallet and added $577.32 back into his wallet, a financial benefit of $4,403.44 in Floyd's favor. If he did that again for another year, and another year, the financial gains become very rewarding. The debt eliminator works, so use it!

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But what if you don't have all $601.38 to spend on your bills?

What can we do to eliminate our debt when we can't make the payments? Simple. Communicate! Talk to your creditor and make an arrangement. There are several different ways you can negotiate with your creditors to allow you some financial options when it comes to paying your debt. The following ways are solutions when asking for relief from your creditors to pay your debts.

<u>Deferment</u>: To postpone or put off payment until a later time, usually at the end of the loan.

If you have payments due, and are unable to meet the obligation to pay those bills, you can ask the creditor to defer the payments for a specific period of time allowing you to stay on track with your creditor and not have a black mark on your financial record. In other words, you can ask your creditor to let you skip a payment or two now and tack those payments onto the end of the loan. Deferments of payments are temporary solutions. Bear in mind that you can't postpone payments forever. If you defer one debt you should be using your finances to eliminate your other debts completely.

<u>Payment Reduction</u>: When the creditor agrees to lower your payments for a period of time.

This method is only for unsecured debt, such as credit cards and unsecured loans. If you need a reduction in the payment amount (so you can use money in other areas that are needed) this is a possible option for a period of time. It will *only* work with the unsecured loans, but it may be significant enough to help you through a difficult time.

<u>Rate Reduction</u>: When a creditor agrees to lower your interest rate for a specified period of time.

If you have ridiculous amounts of interest you have to pay on a credit card, and that's causing you to pay excessive amounts every month, it would be a great idea to call your creditor and ask for an interest rate reduction for a specified period of time. You can use this time to pay down your credit card debt so that when the lower interest rate is gone, your debt is either eliminated or you will have dealt it a significant blow resulting in more manageable monthly payments.

<u>Debt Settlement Reduction</u>: When you request to settle an account and negotiate for a lower payoff amount.

Sometimes it's advantageous to get rid of a debt completely; a debt settlement reduction is an option for some debts (mostly unsecured debts). A debt settlement reduction will allow you to pay off a debt completely for a reduced amount. So say you have a $20,000 debt, and you want to arrange a debt settlement reduction. You'll need a significant portion of it. For our $20,000 example, you would need $10,000 or more to eliminate this debt with the creditor. Once you arrange a debt settlement reduction, you will have a positive listing on your credit report and also no more debt with that creditor.

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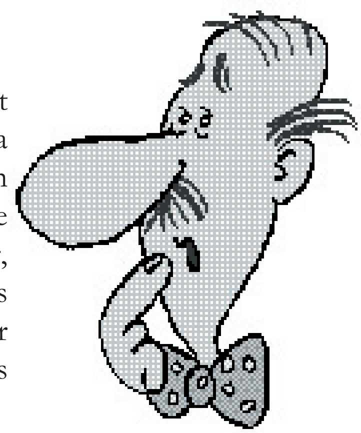
INSTRUCTOR TALKING POINT

Remember that sometimes we don't always have a great financial situation. What we're dealing with in this example is the fact that sometimes we may end up with more debts that we can pay every month. Most people in this scenario go for the "head in the sand" method of dealing with the problem. Financially, this is the worst thing you can possibly do if you find yourself in this situation. Not only will you make your credit score plummet, you will then be dealing with angry phone calls, collection agents, and possible legal issues. At this point, we've already suffered some financial pain. Instead of defaulting on our debts and hurting ourselves even more, we're going to honor our debts and pay all of our creditors fairly. There is a way out of this situation. Let's take a look at Floyd again...

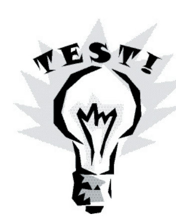
The Debt Percentage Reduction Strategy (DPR Strategy)



Remember Floyd? He'd been working a year and a half at Tallahassee Auto Mart and advanced to a pretty good position as the supervisor of a sales team, bringing in a pretty decent wage for a new worker. The HR department wanted to do a write up on some of their employees and where they came from to post on the wall in their employee lounge. The idea was for everyone to get to know their fellow workers. However, when they contacted Felder & Mark's Big Time Auto Lot, where Floyd had said he was Salesman of the Year with a 78% sales rate, they discovered that Floyd had, in fact, never worked in sales for them at all. He'd been the janitor. Floyd had lied on his resume. As a result, Floyd got fired from Tallahassee Auto Mart.

Floyd had to scramble to try to find a new job quickly. He took the first one that came up to hold onto some income, so he could continue to look for a better paying position. The bad news is that Floyd's debt didn't go anywhere. He still owes money to all those creditors and they still expect him to make his minimum payments. The worse news is that Floyd's new income of $8.25/hr is not nearly enough to make the minimum payments. Does Floyd have any options now?

In the Debt Eliminator example we made the assumption that you had enough money coming in to make your minimum debt payments. What do you do if you find yourself in a situation like Floyd where you don't have enough income to make those minimum payments – say your spouse lost her job, or you lost your job, and had to get another job making less money? The DPR strategy is what you can use if you find yourself in the situation of not having enough income to pay all of your debts.



<u>If you can't pay your creditors what they want, you should treat them all *exactly the same*</u>. You should pay even the ones who are being rude and obnoxious and pay all your creditors as much as you can. Many creditors will accept a written plan and cut special deals with you *as long as you are communicating*, maybe even over-communicating and sending them *some* money.

The DPR strategy works like this: you pay each debt owed in relation to what percent it represents of your total debt. The percent of debt you have with the company determines how much you send them. Floyd took a job at Taco Bell until he can get back on his feet. He's learned his lesson: never lie on your resume. But, now his monthly income is $1,577.48. He's got the same bills with necessities of $1,400 (these are bills you must pay such as rent, food, etc.) but over $300 less money to pay it all. This leaves him with an available income of $177.48, all the money Floyd now has to pay his remaining bills.

Cash Flow Statement

Income		$1,577.48
Necessity Expenses		
Rent	$500.00	
Car Payment	$400.00	
Food	$250.00	
Utilities	$250.00	
Total Necessity Expenses		-$1,400.00
Available Income		$177.48

(Assuming your income will not increase anytime soon.)

Debts	Payoff Balance	Payment
Discover	$2,500.00	$69.44
Visa	$1,750.00	$48.61
MasterCard	$1,250.00	$34.72
Wal-Mart	$725.00	$40.26
Best Buy	$550.00	$55.00
Total	**$6,775.00**	**$248.03**

Floyd's total debts now add up to $6,775.00 and the minimum payments total $248.03 per month. How can he reduce his payments to $177.48 (the actual amount of income he has available to make his payments) and still maintain a fair plan that his creditors will respect?

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Figuring Out Your DPR Strategy

Obviously, we won't all make the same mistakes as Floyd, but even Floyd is doing better than Rachel. Remember her? She resorted to crime in order to keep her head above water. Floyd, on the other hand, is trying to make the best of a bad situation, and there are plenty of legal ways to deal with debt. Debt Percentage Reduction allows you to work with your creditors and keep yourself from drowning in that sea of debt. The creditors are not going to like this negotiation. Some may even get rude about it, but when it boils down to it the important thing that they want to know most is that you don't intend to declare bankruptcy and you do intend to pay your debts. Here's how it works:

Floyd had $177.48 per month in available income, but $248.03 in payments due. He wants to pay each creditor a fair amount of the $177.48 that he has available. He owes $2,500 on his Discover Card and his minimum payment is $69.44. Using the DPR strategy, he takes the $2,500 owed to Discover and divides it by his total debt of $6,775 ($2,500 ÷ $6,775 = .369 or 36.9%). That means Discover gets 36.9% of the $177.48 he has available (36.9% times $177.48 = $51.80) Visa is 25.83% of his total debt so they get 25.83% of the $177.48, or $36.26. Each creditor gets their fair share of the $177.48, no one gets less, and no one gets more. Here's the formula and chart you use to figure out the DPR strategy:

INSTRUCTOR NOTE

Use the board to go over this math as well. Note that Floyd's total debt is even lower than the US average now. He's obviously been paying off his debts pretty well while he could, but he racked up some more in the process. Even with a reduced amount, he's still in trouble here. The key points to drive home here are: COMMUNICATION and TRANSPARENCY. You will want to communicate as much as possible to your creditors as often as they want and be clear about ALL of your finances and your financial situation.

Creditor	Debt (Amount We Owe)	÷	Total Debt	=	Debt %	Debt % x Available Income of $177.48	=	New Payment
Discover	$2,500	÷	$6,775	=	36.9%	36.9% x $177.48	=	$65.49
Visa	$1,750	÷	$6,775	=	25.83%	25.83% x $177.48	=	$45.84
MasterCard	$1,250	÷	$6,775	=	18.45%	18.45% x $177.48	=	$32.75
Wal-Mart	$725	÷	$6,775	=	10.7%	10.7% x $177.48	=	$18.99
Best Buy	$550	÷	$6,775	=	8.12%	8.12% x $177.48	=	$14.41
Total Debt	**$6,775**					**Available Income**	**:**	**$177.48**

*Note that these payments are calculated with interest included. Interest is charged in the following amounts:
Discover: 23%
Visa: 21%
MasterCard: 21%
Wal-Mart: 17%
Best Buy: 12%

Now that you have the strategy figured out, print it and attach it to the letter found on the following page. Send the letter to each creditor *every month* that you make a DPR strategy payment which is lower than your minimum.

INSTRUCTOR NOTE

Underlined portions of this sample letter are NOT filled in in the student manual.

DPR Sample Letter

January 17, 2017

Discover Card
123 Main St. Suite 227
Anytown, FL, 12345

Re: Account # 5731332544689712

Dear Discover:

Recently, I lost my job and had to take a temporary job until I find better employment. I acknowledge my indebtedness to you of $2,500.00. My minimum monthly payment to you should be $69.44. I am not able to meet these minimum payment requirements right now. I intend to pay you back in full; however, you are one of 5 creditors to whom I owe $6,775.00.

I have enclosed a necessities cash flow plan based on my take-home pay of $1,540.38 per month. Since I have a family to support, and limited available income currently to pay my creditors, I can only make a payment of $51.80 to you at this time, but I do not intend to go into bankruptcy.

Consequently, I am asking for a deferment of any arrearage payments for the next 60 days; as well as a payment reduction for 60 days to match the amount I have listed above. I will keep in close contact with you, and I will resume making full payments as soon as possible. If possible, I would like to request a reduction of interest during this time.

I am aware that this is an inconvenience to you, but I must meet the basic needs of my family first. I fully intend to pay my creditors all that I owe them. Please be patient with me. If you have any questions, please contact me at 868-867-5309.

Thank you for your consideration.

Sincerely,

William Babbage
456 Main St. Apt 2
Anytown, FL, 12345
868-867-5309

Finally, answer your phone if the creditors call. *Communicate* with them. Let them know you're in a hardship but that you fully intend to pay off your debt. They won't like the DPR Strategy very much, but they will prefer it to no payment at all. You will find that many times they are willing to work with you to get their money back, *if you communicate*.

REEFS

Chapter 4 - Buying an Automobile

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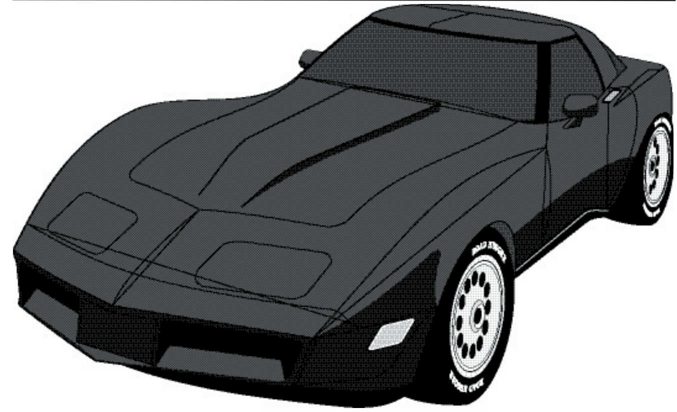
Susy-Becky sat on the bus and cringed into her seat as she did each and every weekday. On her left, a large woman named Bertha whose breath stank and who laughed too loudly nudged Susy-Becky in the arm every time she told some ridiculously stupid joke about her friend Corrine. A mousy little drunk man named Pete sat on the other side of Susy-Becky, smelling like the bottom of a wine barrel that had been left out in the sun for far too long. Not only that, but the bus itself seemed to inch along, prolonging her torture and threatening to make her late.

"And, then… and, then… Corinne says, 'I know! I've never walked to church, either!' BWAHAHAHA!!!" chortled the smelly woman. She sounded like a cow trying to pass a kidney stone to Susy-Becky. Why, oh why, did this have to happen every single day??

Susy-Becky tried to take a deep breath and relax, but all she got was a lungful of Eau de Pete. Feeling sick, she closed her eyes, covered her nose, and tried to concentrate on the good things. After two years of unemployment, the job at Credit Bureau had been a godsend. Respectable pay and the hours were decent. But, the stress… Good God! All day long she had to deal with quotas. She lost count of the amount of papers that landed on her desk, all of which had to be answered in four minutes or less. The mountain of paperwork just got bigger and bigger every day. After two weeks, she felt like she was looking up at Mt. Everest whenever she sat down. Her nerves felt like a balloon about to burst.

Her co-workers were no help, either. Peggy could only be counted on to eat everything in sight. He spent all his time looking lost and mumbling way too loudly. Tyrone just looked angry all the time, like he wanted to punch holes in the wall. Phil was even worse. That smug jerk hardly ever even looked busy, but he had the least work out of all of them. Worst of all was their boss, Mr. Crabwick. He started screaming if Susy-Becky clocked in so much as 10 seconds late. She felt like running and hiding every time he started in on her with those crazy eyebrows of his and his cheeks burning red. Something had to change soon or poor Susy-Becky would end up in a mental hospital!

She's been thinking a lot about ways she could make things easier on herself. She couldn't change the crazy quotas they put on her or the amount of paperwork she faced, but maybe she could do something about getting to work earlier in order to avoid the awful Mr. Crabwick. Looking at her budget, she saw an option. She might just be able to afford a car. She wouldn't have to sit next to Smelly Pete or have to listen to Bertha guffawing with her awful breath as she shoved her elbow into Susy-Becky's ribs. More importantly, she could get to work on time no matter how slow the buses were running.



"And, then Corrine said, 'Have you ever seen a Chihuahua scream like that?!' BWAHAHA!" roared Bertha in a wave of halitosis. That decided it. Susy-Becky was getting a car!

The fact that we all face is that it's sometimes necessary to own a car. Depending on where we live, we may be able to get by without it. Despite her problems, Susy-Becky lived in a place where she could get to work on the bus. That may be the reality of our budget. But, what if we aren't able to live near a bus route like she did? What if our job requires us to have a car or if we need to go to appointments or meetings at odd hours? Some of us may need to fit a car into our budget no matter what we do. Owning a car is expensive, but, if done the right way, it can not only be possible but actually help our credit.

INSTRUCTOR TALKING POINT

It is crucial to understand, in your private world of personally managing your finances, that a vehicle is not, and never will be, an *investment*. A vehicle is one of the fastest depreciating purchases you will ever make. That said, it *can* actually help our finances to own a vehicle, if we do it the right way and for the right reasons.

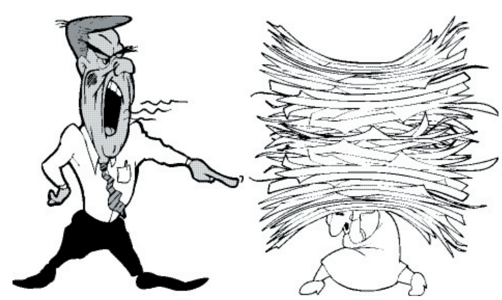
Every one of us has the desire to drive a cool car. Maybe we see the car we drive as a reflection of our personality, or we might legitimately just need a car for work purposes. Whether or not you care about looking good while getting from point A to point B, there are common pitfalls that we all run the risk of falling into when purchasing a car. Although we may not be able to purchase the car of our dreams right away, if we are disciplined enough and play by the rules we will eventually get there. In this chapter, we're going to talk about how.

So, let's start by taking a look at a typical scenario and see what kind of mistakes we can make.

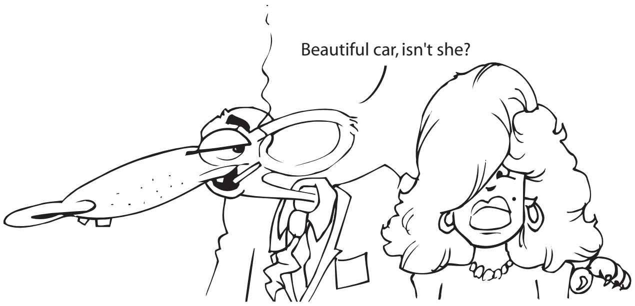
In this chapter, we're going to change the way we think about car ownership. Purchasing a car is not just about the payment; it's about the total cost of owning the car. Many people take buying a car very lightly. They look at the payments or they buy a cheap old used car that they like and call it a day. What we need to do is think bigger than that. A car is the fastest depreciating asset that most of us will ever own, but it can be a tool to help us in many more ways than simply getting us to work and back a little bit faster. Let's take a closer look at the process and see how many mistakes Susy-Becky made that we can learn from.

At the Dealership

On Saturday, Susy-Becky is desperately trying to wind down after another hard week at work. Her nerves are on edge. In the back of her mind, that mountain of paperwork looms, waiting for her to return to it on Monday. But, this weekend she has an advantage to help her de-stress. She's buying a car! No more bus. No more Bertha or smelly Pete. No more screaming Mr. Crabwick. She had a little skip in her step as she walked onto Felder & Mark's Big Time Auto Lot, conveniently only four blocks from her apartment.



F&M sure did have a ton of cars. It intimidated her more than a little bit when she looked out over the vast array of new cars, old cars, shiny cars and cars that had, to be honest, seen better days. With no one in sight to help her, she wandered around the lot looking in windows and trying to look like she seemed to know what she was doing as she looked under the few raised hoods. She kept coming back to this one car with lots of personality, a cute shiny lime green one. It happened in the moment that she decided that this was the car she liked most. A smiling salesman seemed to materialize out of thin air right at her elbow.



"Beautiful car, isn't she? She just came on the lot yesterday. Straight from the factory," said the man with a friendly smile. Susy-Becky caught herself as she jumped, startled at the man's sudden appearance. He seemed nice, though, and he held out his hand in a friendly way. "I'm Terry. How can I help you?"

"Oh. Uh… Susy-Becky. I was just looking at-" Susy-Becky started to say as she shook his hand.

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"Yes. It's a fantastic car, isn't it? Do you know I can just picture you driving into town in this car? Wind in your hair. Living life to the fullest, right? You only live once, after all. Step into my office over here, and we can talk about it. I'd love to see you drive off in this car today."

"Oh. Alright," said Susy-Becky. She followed along, nervous but encouraged by the salesman's confidence. Inside, there was a comfortable and exciting air, the mingled scents of new car and coffee drifting about. Susy-Becky sat across from Terry and smiled back at him as he worked at his computer for a minute. After some small talk, Terry's assistant brought out some coffee and the real negotiations began.

"I really want to help you with this. I want to see you drive off in that car today and never have to be at the mercy of the bus system again. Tell me, how much were you looking to pay per month?" asked Terry.

"I was hoping for around $350 a month. I have $3,000 that I can put as a down payment," said Susy-Becky with confidence.

"$350 definitely sounds do-able. Let me get your information, and we'll see what we can do."

"Thank you," said Susy-Becky and fished her driver's license out of her pocketbook. Terry entered her information into his computer and nodded with a fresh smile for a moment as he handed back her license and waited. His smile slowly faded as he read what was on the screen.

"Hmm…" he said worriedly.

"What is it?"

"Well… It looks like your credit isn't… perfect. I can get you in the car. There's no problem about that, but I'm looking at a monthly payment of about $435.63 here."

"Oh, no. That's way more than I can afford," Susy-Becky said firmly. No way was she going that far over her budget.

"I really want to see you in this car. It was made for you. Let me talk to my boss for a minute, and I'll see if he can approve this for a lower amount. Okay?"

"Yes. Okay," said Susy-Becky. Terry left her sipping her coffee as he walked off out of the office. Susy-Becky looked around the office for a few minutes. If she leaned back, she could just see Terry in another office across the way talking to someone out of sight. She gave a little nod. This was going pretty well, really, and much easier than she had thought it would be. Within a couple minutes, Terry was back. "Good news?"

"I think so. Let me just punch in the numbers my boss gave me," said Terry. He sat down and tapped at his keyboard again for a moment. "He gave me a hard time about it, but I explained your situation and talked him down to monthly payments of $375.08."

"Oh, that's still more than I was hoping to pay," said Susy-Becky. Terry wasn't the only one who could play hard-ball here. She'd stated her price, and she was sticking to it.

"It's only $25. You can't find $25 a month? Susy-Becky… Come on. I could find you $25."

"I know it's not that much more, but…"

"$25 is $25, right? Let me… Do you think you could put any more down? That would make it a lot easier to deal with my boss. He's kind of old school, and can be a little aggressive, if you know what I mean."

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"Um… maybe a little bit," said Susy-Becky with a sigh. She hadn't wanted to take so much out of her savings. It had taken a year just to build all that up. Still, if it wasn't that much more than she'd planned on spending it might be okay.

"If you could just do an extra $500, I'm sure I could get him to come down on the monthly payments to where you need it to be."

"I… Yes. I think I could do that," Susy-Becky replied, doing the math in her head. She'd just have to go lean on the Christmas spending this year. It would be worth it if she walked away with a new car.

"Okay. Let me talk to him again. I won't be a minute," said Terry. He disappeared back into the office across the way. Susy-Becky watched him this time as he seemed to get into an argument with whoever was in there. She nodded with satisfaction. Maybe all salesmen weren't bad. Terry really seemed to be going to bat for her.

"It looked like you were arguing in there," she said when Terry returned looking a little ragged.

"Yeah. He didn't like the idea, but I got him to come down again. It's really his last offer on the Civic, though. Let me just put in his numbers," said Terry. He tapped at the keyboard one more time. With a wide, confident grin he nodded when he looked back at Susy-Becky and said, "If you can put the extra $500 down I've got you a payment of $345.92 per month. You can drive out of here today."

"Really? Well, that's fantastic!" said Susy-Becky, and she reached back into her pocketbook for her credit cards. Terry smiled as he reached to take them out of her hands.

Susy-Becky got her car! She even managed to get it for slightly less than the price that she had in mind. She walked away from the deal happy. The salesman walked away from the deal happy. Everyone was happy, so it must have been a good deal, right? Actually, no. They say a sucker is born every minute. Both Susy-Becky and the salesman were laughing at each other here, but the sucker in this situation is not the salesman. Car dealers don't make millions in profits every year because they're suckers. Susy-Becky made a lot of mistakes. Let's take a look at what she did wrong by taking a step back and looking at this from the other side of the transaction. What's really going on here as Susy-Becky walks onto the car lot?

Terry leaned back in his chair watching the game on the little TV that sat on the shelf under his desk. Things had been going well lately. Sales always picked up around the holidays with no shortage of saps wanting to buy a car for their girlfriends. In fact…

Terry sat up in his chair with a grin as he spotted the small woman walking around the lot, peering into windows. Terry couldn't help smiling widely as he saw that she looked completely lost. He rubbed his hands together in anticipation, watching as she roamed around and kept coming back to a new Honda Civic. He could almost taste the blood in the water.

And, here we see Susy-Becky's first mistake. Shopping for a car is not like shopping for clothes or food. It's a huge purchase and requires some more investment on the part of the customer. When you buy cheese, you're buying something that's made to be consumed. When you buy a car, you're purchasing an asset. The first key here is to know what your asset is worth and make sure that you are getting the best possible asset for your money.

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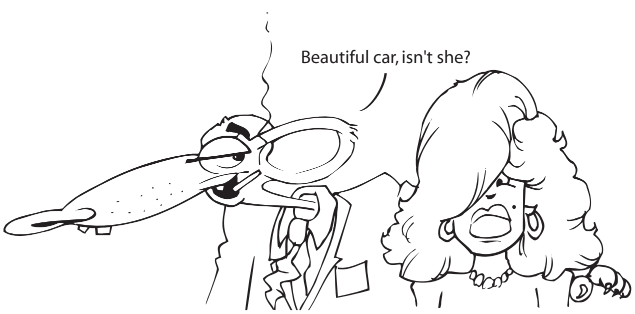
Susy-Becky walked in not having the slightest idea what she wanted. She had no idea about price or value; she decided on a car by the way it looked which was the exact wrong thing to do. Her first step should have been to figure out the exact car she wanted, down to the details of exterior color, interior color, and all the needed extras. This used to be a very time-consuming process (visit multiple car lots, research classified ads, buying a Kelly Blue Book, and so on…) Today, we have a mountain of resources at our fingertips. Remember when we talked about the importance of getting a Smartphone? This is another one of the reasons why. Using our phone, we can visit the Internet, visit the manufacturer's website, and learn about your options. You can look up the history of a specific car on sites like CarFax.com by inputting the VIN. The next step is to figure out what that car sells for in the marketplace. You don't do this by visiting one local dealership. Call on the phone, use the Internet, visit several dealerships, and **do your research**. You need to know exactly what you're buying and how much it's worth.

"Sucker in aisle five! Cleanup on aisle five!" said Ray, emerging from his little office across the way. Terry glared at him.

"Dibs! I saw her first," said Terry, staring him down. Ray complained but gave in. He'd gotten the last schmuck that had wandered in. It was Terry's turn, and it looked like the new fish had just taken the bait. The little lady had settled in, smiling at the Civic like it was an old friend. Terry was up and outside so fast that his chair was still spinning in place by the time the door shut.



"Beautiful car, isn't she? She just came on the lot yesterday. Straight from the factory," he purred as he reached the sucker. Err… customer. She jumped a little, startled that she didn't hear him approaching, but she nodded slowly. This was all going to be easier than taking cheese out of a refrigerator. Terry extended his hand with a warm, practiced smile. "I'm Terry. How can I help you?"

"Oh. Uh… Susy-Becky. I was just looking at-" said the little lady. She shook his hand and nodded at the Lime Green Honda Civic.

"Yes. It's a fantastic car, isn't it? Do you know I can just picture you driving into town in this car? Wind in your hair. Living life to the fullest, right? You only live once, after all. Step into my office over here, and we can talk about it. I'd love to see you drive off in this car today."

"Oh. Alright," said Susy-Becky. She followed along, as he led her into the office.

Inside, she sat in the soft chair across from Terry as he settled in and punched the password into his sales computer. He called up the info on the Honda Civic in about three seconds. It just got delivered two week ago as part of a batch from Honda. Mr. Felder paid $14,000 for it and wanted to turn around $11,000 in profit from the sale. That meant a $25,000 loan for Susy-Becky. He tapped on some number keys for another minute for effect before turning back to Susy-Becky. He gave her another easy smile and asked, "Would you like some coffee?"

"Oh! Thank you," Susy-Becky nodded with a smile. Terry motioned at Ray, who shot him a dirty look but got up to get the coffee.

Terry made some small talk that he knew would interest the sucker. 'Ask about their lives' was the first rule of sales. Susy-Becky was all too happy to talk about having to ride the bus and got in some complaining about her co-workers by the time Ray came back with the coffee. He glowered at Terry but smiled when he handed a cup to Susy-Becky at least before he walked off again and disappeared into his office.

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This is Susy-Becky's second possible mistake. Back in Chapter One, we discussed psychological marketing. It's just as prevalent at the car lot as it is at the grocery store. Most of it we're aware of. Some of it we're not. A good professional dealership will even arrange the cars in a certain way to maximize interest. That smell of coffee and new cars as you walk in is carefully calculated, and the salesman is usually not asking about your life because he is so very interested. Always remember that his goal is the opposite of yours. Terry, in this situation, wants to sell Susy-Becky the most expensive car she will sign for at the worst possible terms. Susy-Becky should be wanting to get the best possible terms for the greatest value.

It seems obvious, but so many people fall for it. Don't be drawn in by the small talk. There's nothing wrong with being sociable, even in this situation, but always remember what's really going on in this transaction. It's the salesman's job to make you forget that and think you're just talking to a friend with your best interests at heart.

Terry nodded sympathetically as the chump sipped at the coffee and said, "I really want to help you with this. I want to see you drive off in that car today and never have to be at the mercy of the bus system again. Tell me, how much were you looking to pay per month?"

"I was hoping for around $350 a month. I have $3,000 that I can put as a down payment."

"$350 definitely sounds do-able. Let me get your information, and we'll see what we can do."

Susy-Becky's third mistake just happened. Notice that Terry didn't even ask twice about the down payment. That's because Susy-Becky has shown no sign of having any idea what the car she chose is actually worth. Without knowing the actual cost, how can she have any idea about what her payments should be or how much she should put down? Let's look at the real cost of owning and operating a car.

Car ownership costs are basically of two kinds: Fixed costs, which are not affected by the amount of driving you do; and variable costs (also called operating costs), which depend on the number of miles you drive your car. Both depend on the type of car (and extras) you buy in the first place.

What you want to figure out is the real cost **per mile** of running your car. You can figure the real cost, per mile, by dividing your total fixed and variable costs by the total number of miles you drive over any period of time you choose.

(FIXED COSTS + VARIABLE COSTS) / TOTAL # OF MILES PER YEAR = COST PER MILE

'Depreciation' is the amount of value a car loses as it becomes older. It's a major factor for you to consider whether buying or leasing a car. This table is taken from the National Automobile Dealers Association's (NADA) USED CAR GUIDE. According to the NADA, the average car loses 30% of its value the first year it is driven. A brand new car that you buy for $25,000 loses $7,500 in value within one year and is then worth $17,500. In the first three years of car ownership the car loses 62% of its original value, or $15,500 in the case of Susy-Becky's "$25,000" Civic. How do you use this information? **DON'T BUY THE CAR FOR THE PAYMENT**. Start buying based on total car cost. To do this, you must understand the cost of depreciation.

Average Automobile Depreciation Schedule

		($25,000)
Year 1:	30%	$7,500
Year 2:	18%	$4,500
Year 3:	14%	$3,500
Year 4:	11%	$2,750
Year 5:	8%	$2,000
Year 6:	6%	$1,500
Year 7:	5%	$1,250
Year 8:	2%	$500

INSTRUCTOR TALKING POINT

As a car depreciates (and the loan depreciates) the car loses value. The biggest mistake people make is that they make a car-buying decision based on the monthly payment. THE PAYMENT IS NOT WHAT'S IMPORTANT. It is a huge disadvantage to the consumer and a huge financial gain for the car dealer. The actual cost of the car can easily be tucked away in the fine print of the loan, while the customer happily looks at the monthly payment and thinks they can afford the car. Statistics show that 70% of cars are underwater the moment the car leaves the lot. Let's say that again: The majority of people owe more than the car is actually worth the moment they drive off with it. This is due to poor planning, a tremendous lack of knowledge, and most importantly a lack of emotional control (I want it, and I want it NOW!).

What you need to know is how much the car costs, not how much you're willing to pay for it. The dealer in Susy-Becky's case is asking all the wrong questions. Or, to put it more correctly, he's asking all the right questions *for him*. Those questions probably sound very familiar to most of us, though. The key here is to have the knowledge you need before you run into a situation that requires it. So, let's look at figuring out how much a car actually costs us over the course of the loan.

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In Susy-Becky's example: She's looking to buy a $25,000 new car. If she drives the car for three years and then trades it in on another new car (by the way, the average American keeps a new car for three years), then the total cost of ownership is as follows:

Fixed Costs:	
Depreciation (three years):	$15,500
Registration ($50 per year):	$ 150
Purchase Tax (7%):	$ 1,750
Finance Cost (one time):	$ 500
Insurance Cost ($1,000/year):	$ 3,000
Total Fixed Costs:	**$20,900**

Variable Costs:	
Gas ($110 per month):	$3,960
Oil ($25 per quarter):	$ 300
Maintenance/Parts ($25/mo.):	$ 900
Accessories:	$ 250
Tires:	$ 600
Total Variable Costs:	**$6,010**

Total Costs: $26,910

Now that you have established the total cost of ownership, $26,910, you divide that by your average mileage of 36,000 miles (12,000 miles per year) and find that your mileage cost is: $.75 per mile. Of course, your cost per mile will vary depending on your driving habits; the higher the mileage the lower the cost per mile and vice versa. Different cars will also have different expenses. A Ford Mustang will have higher gas and insurance costs than a Chevy Malibu. As with any kind of shopping, the most important thing you can do to start with is comparison shopping. Once you have your cost per mile figured out on different cars, you can make a side-by-side comparison to figure out the best value.

Why is this so important? Universally, one of the first questions the sales representative will ask the car buyer is: "How much are you looking to spend?" When you buy a car based solely on whether you can afford the monthly payment, you end up with a very expensive total car cost.

"Thank you," said Susy-Becky and fished her driver's license out of her pocketbook. Terry entered her information into his computer and nodded with a fresh smile for a moment as he handed back her license and waited. He let his smile slowly fade while her credit report came up on the screen. Susy-Becky's credit score wasn't terrible, a 650. He could get her a good 7% interest rate. With $3,000 down, that brought the loan amount down to $22,000. Their standard loan length was 5 years. He punched up all the numbers and then shook his head with as much pity as he could muster.

"Hmm…"

"What is it?" asked Susy-Becky nervously.

"Well… It looks like your credit isn't… perfect. I can get you in the car. There's no problem about that, but I'm looking at a monthly payment of about $435.63 here."

"Oh, no. That's way more than I can afford."

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This should have been Susy-Becky's clue that she was making yet another mistake. First, how did she decide on $3,000 down? How much should you put down on a car loan? The quick answer is: as much as you can. You want a minimum of one-fourth to one-third of the purchase price of the vehicle. Susy-Becky went through this entire transaction without ever doing one very important thing that should be glaringly obvious. She never did her research ahead of time and, more importantly, she never even asked how much the car cost. The dealership wants to sell the Civic she was looking at for $25,000, meaning she should be putting between $6,250 and $8,333 down. What if she had put down $6,250 on the car (the absolute minimum she should have been considering)? With the same loan terms (7% interest, 5 years), her monthly payment would have been $371.27. That's much closer to what she was hoping to work with in her budget. If she'd put the full $8,333 down, her payments would have been $330.03.

The math here is simple. Put down as much as you possibly can to reduce the loan amount. But, there's more going on in this equation. Suppose Susy-Becky only had $3,000 to put down on a car. Her payments for the Civic are then stuck at $435.63 per month for a five year loan. What does that mean? She said it herself. "*That's way more than I can afford*." The problem was not that Susy-Becky needed a lower monthly payment. The problem was that Susy-Becky needed a cheaper car. Had she done her homework and realized that she should have been looking at something more like a Honda Fit ($12,000) than a Honda Civic ($25,000), she might have come out a little better in this transaction. For a $12,000 car with $3,000 down and the same loan terms she was looking at before, her monthly payment would have been $178.21, which fit well within her budget.

Susy-Becky went into this purchase with no information. That was the single biggest mistake she made. She had no knowledge (**K**) and so had no power (**P**) or control (**C**) of the negotiation. The second thing she should have done after comparison shopping and finding out the value of the car she wanted was to look for financing.

As with anything else, you want to find the best possible deal in financing the car, assuming that, like most buyers, you don't have several thousand dollars lying around to pay cash and instead intend to buy using credit. On top of interest rates on automobile loans, financing costs are being increased by the trend toward longer and longer repayment periods (typically three years on a used car, five to six years on a new car); lower and lower down payments (often only 5 - 10%); and larger and larger loans (the other 90 - 95%).

The Best Ways to Shop for an Auto Loan

Here is how you shop for the best deal in financing your car:

- Ask the dealer you intend to buy the car from exactly what financing terms he'll offer. Don't consider any deal unless the total financing charges, over the full life of the loan, are spelled out clearly in writing – including the amount of the cash down payment, the unpaid balance to be financed, and the true annual percentage cost. This detailed disclosure is required by the Truth in Lending law, be warned if it isn't made.
- Ignore slogans! "Easy payment terms", "No money down? No problem!", and "No credit? Bad credit? No problem!" should all send you running for the hills. You need to arm yourself with knowledge and find out exactly what these terms actually mean in dollars and cents.
- Plan to make the biggest down payment you can – if possible, at least one fourth to one third of the purchase price – and try to repay in the shortest period possible. Of course, the monthly payments will be larger this way than if you stretched out the loan, but you will save thousands of dollars in interest.
- Once you have the facts on financing a car through your car dealer, visit the local bank or credit union. Ask the auto loan department what terms they offer. Make sure variables, such as the down payment and the period (in months or years) during which the loan will be repaid, are the same when comparing each lender's terms.

INSTRUCTOR TALKING POINT

So when it comes to financing, a lot of factors come into play to affect how much you will pay. One of the biggest is your credit score - the higher the score the cheaper the money, the lower the score the more expensive the money. Post prison money will be expensive due to a low credit score (and many of us won't have a lot to put down as a down payment). How can you help that situation? Taking Credit & Debt Management would be a great place to start. It's an extremely useful course that teaches you how to start improving your credit right here from prison.

How many of you have seen those advertisements on TV? "No Credit? Bad Credit? No problem! Come on in! Everyone's approved! Just $7 down!" Don't fall for it. Why would a car dealership offer loans on these terms? The short answer is: money. Remember when we talked about those Green Light customers at the bank? That could be someone who has multiple accounts in good standing at the bank. Or, it could be someone who racks up a lot of overdraft fees. Car dealerships work under the same principle. It used to be that they didn't want to talk to you if your credit was bad. Then, somebody figured out that the dealership can make a LOT more money if they sell the same car multiple times. How do they do that? By selling the car to someone who they know might default on their loan. Then, the dealer gets to reposess the car and resell it to the next chump. Err... customer. Even if all they get out of you is the down payment, they're still making money.

What about letting you only put $7 down? Sounds great, right? What they'll do is stick you with a ridiculously high interest rate and, at a minimum, a 5 - 7 year loan. And, that fine print we keep telling you to read? It's especially important here. The majority of these types of contracts will be like a Satellite TV contract - great terms for 6 months, then you start paying the REAL rate. A car dealership might even offer you "no interest for one year." At the end of which, all those interest payments you *should* have been paying come due all at once.

The whole idea here is to get you in the door and get you to sign for the worst possible terms for *you*. Don't fall for it. The down payment is to generate equity in the car and, more importantly, encourage financial strength and encourage creditors to finance the car for you. It's critical to purchase the car for the right price. If the price is too high, then the car will get financed at an amount that exceeds the value of the car. Then, you will never be able to gain value from that car.

Just how good of a deal is a car sale for the *dealer*? As a general rule of thumb: on a new car that's never been titled before, the profit margin for the dealer is between 6% and 11%. (On Susy-Becky's Civic, that equals $1,500 - $2,750. And, guess which end of that scale the dealer will be aiming for.) Once the car has been titled, it's considered used (even if it has no miles on it). On a used car the profit margin can be anywhere between 10 and 30%. With a shady dealer, it could be even higher. The newer the car, the cheaper the money, and the easier the financing since the collateral for the loan is the vehicle itself.

Another tip is to never include the taxes on the car in the loan. By including taxes within the loan you're simply setting yourself up for failure. It will cost you the financial sacrifices you've made and erode any progress you hoped to make with a higher down payment. As an example: on a $10,000 car (tax, tag, title = $1,000) if you plan to put $1,000 down, the $1,000 you put down only pays for tax, tag and title, making the down payment useless. **Don't take one step forward only to take three steps back. Allow yourself to take one step back so you can take three steps forward.**

Comparison shopping: this is the most vital tool you have in any transaction you make. Most of us think of this in terms of groceries or clothing, but why not apply it to any purchase? An auto loan is a huge purchase for a rapidly depreciating asset. Give yourself as much knowledge as you can possibly get in every aspect of making this purchase. With that knowledge, you now have the power to make an informed decision and to control the situation during the sale, unlike what Susy-Becky was doing.

In general, the most expensive sources for automobile credit are new and used car dealers. Let me reiterate that. The absolute worst place you could get an auto loan from is the auto dealer! The automobile finance companies which work with them are not designed with your best interests at heart. Small loan companies are the second worst, though not very far behind. The least expensive sources are credit unions, which usually charge the lowest rate of true annual interest and which tend to lend relatively large amounts toward the purchase of new or used cars; commercial banks, which charge auto loan interest rates generally comparable to those of credit unions; and life insurance companies, if you have a policy with a cash value against which you can borrow at the lowest rate of all.

Money Saver! The Internet has made auto loan comparison shopping easier than ever. Several websites allow you to compare hundreds of banks and finance companies in one easy location, and the competitiveness usually means you get a superior rate and price as a consumer.

Notice that the car buying experience has been broken down into three steps:

1. <u>Figure out the exact car you want, down to the details of exterior color, interior color, and all the needed extras.</u>
2. <u>Figure out what that car sells for in the marketplace.</u>
3. <u>Find the best possible deal in financing the car.</u>

Most people simply purchase and finance their car at the dealership. The dealership makes a big profit from selling the car and another big profit from arranging the financing. The car buyer, blissfully unaware of the total cost of their new car, drives away none the wiser. Susy-Becky thought she walked away with a great deal. She didn't. And, we didn't even stick around to find out what else the salesman might have tacked onto the contract after the fact. By breaking the car buying experience into three steps, and dealing with multiple channels, you can significantly lower your total car cost. You also reduce the possibility of impulse buying, the old "ah what the heck" or "why not" that you have been talked into by the car salesman.

"I really want to see you in this car. It was made for you. Let me talk to my boss for a minute, and I'll see if he can approve this for a lower amount. Okay?"

"Yes. Okay," said Susy-Becky. Terry left her sipping her coffee hopefully and walked over into Ray's office. Ray looked up with a raised eyebrow as Terry closed the door behind him and sat on the edge of Ray's desk.

"What's up?" said Ray.

"Nothing," Terry smiled. "Did you catch the game last night? It looked like they were playing in a damn blizzard."

"Yeah. Think they have heaters in their gear?"

"They gotta have something because that looked freezing."

"How's the sucker?" said Ray, leaning over to look out the office window at Susy-Becky.

"She's fine. You going to the Christmas party?"

"I don't know. It was a whole lot of hassle last year. Remember Lonnie?"

"Yeah," said Terry with a sigh. "Never seen anyone complain about a Secret Santa before. I'd better get back out there. Talk to Christie. I think she's doing her own party this year."

"Yeah, will do," said Ray. Terry opened the door again and strode purposefully back to his desk with a big smile for Susy-Becky. She smiled back, beaming with hope.

"Good news?" she asked.

"I think so. Let me just punch in the numbers my boss gave me," said Terry. He sat down and called up his loan screen again. He upped the loan length to 6 years and sat back. "He gave me a hard time about it, but I explained your situation and talked him down to monthly payments of $375.08."

"Oh, that's still more than I was hoping to pay," said Susy-Becky, looking a little crestfallen.

"It's only $25. You can't find $25 a month? Susy-Becky… Come on. I could find you $25."

"I know it's not that much more, but…"

"$25 is $25, right? Let me… Do you think you could put any more down? That would make it a lot easier to deal with my boss. He's kind of old school, and can be a little aggressive, if you know what I mean."

"Um… maybe a little bit."

"If you could just do an extra $500, I'm sure I could get him to come down on the monthly payments to where you need it to be."

"I… Yes. I think I could do that."

"Okay. Let me talk to him again. I won't be a minute," said Terry. Back in Ray's office, they had a coffee and spent a good five minutes talking about who they liked for the Superbowl. Ray got a little animated. He insisted on backing the Lions every year. Some things were just too easy. Finally, Terry took a deep breath and walked back out to see Susy-Becky once more.

What's going on in this situation? Any time you've purchased a car, the salesperson has had a large number of negotiation tactics to use on you. They've probably used several. The particular one that Terry is using here is to separate the buyer from the decision maker. By going to "talk to his boss", Terry is removing the responsibility for making the decision from himself. This does two things. First, it makes him look more sympathetic in Susy-Becky's eyes. Now, he's doing the negotiating on her behalf, which gives the appearance that he's "on her side." He's the one begging for favors so that she doesn't have to, after all. Is he really on her side? Not even close.

The second thing this does is that it separates the buyer from the person who can actually make the decisions. Now, if things go badly, Terry can claim that his hands are tied. After all, it's not him being stubborn and cruel. It's his boss. It's not his fault, and by not agreeing to the terms now Susy-Becky is making Terry (her new best friend) suffer. What this tactic ultimately does is reduce your standing (as the buyer) in the negotiation.

Our example is extreme, of course. It's entirely possible that Terry really was going to talk to his boss about loan terms. Either way, if you find this tactic being used on you there is one easy way out. Stop talking to Terry. Your best bet is to ask to speak directly to the owner or manager. This is true whether you're buying or selling. Don't waste time trying to negotiate with someone who has no authority.

"It looked like you were arguing in there," she said timidly.

"Yeah. He didn't like the idea, but I got him to come down again. It's really his last offer on the Civic, though. Let me just put in his numbers," said Terry. He tapped at the keyboard once more. With a wide, confident grin he lowered the loan amount to $21,500, upped the loan length to 7 years, and, while he was at it, upped the interest to 9%. He nodded when he looked back at Susy-Becky and said, "If you can put the extra $500 down I've got you a payment of $345.92 per month. You can drive out of here today."

"Really? Well, that's fantastic!" said Susy-Becky, and she reached back into her pocketbook for her credit cards. Terry smiled as he reached to take them out of her hands.

So, now Terry, who gets paid a percentage of sales as commission, is just making up numbers. It's not really too bad, though, right? After all, he's merely making the numbers fit what his customer was asking for. She wanted to pay $350 per month. He's making her pay $350 per month. Even better, he's saving her $4.08! Let's look at the actual numbers.

Susy-Becky is now putting down $3,500 on a $25,000 loan. At the original terms (7% interest for 5 years), this still puts her monthly payment over her budget ($425.73). Terry, nice guy that he is, ups the length of the loan to 7 years. He could have left it at that, making her payments $324.49 per month. For that matter, he could have made the loan for 6 years and given her a payment of $366.55, but by putting her at 7 years he was able to up the percentage rate to 9%. Susy-Becky, with no knowledge in her head, made the decision that most car buyers, believe it or not, make. Great! That's exactly the payment I was hoping for. She bought the payment, not the car.

Again, her biggest mistake going into this whole situation was a lack of knowledge. She could not afford the car she was looking at. What's the big difference between paying for a car for 7 years at 9% interest as opposed to 5 years at 7% interest? Monthly payments aside, the first difference is the extra $3,513.33 she'll be paying in interest. Beyond that: remember when we talked about depreciation? After three years, Susy-Becky's car will only be worth $10,000 (because it will have depreciated 62% by then). With the 5 year loan, she's doing well. She still owes $9,508.63, but she's ahead of the depreciation value by almost $500. By going with the 7 year loan, however, she still owes $13,900.53 on the loan. She's "upside-down" on the loan by $3,900.53. In other words, she still owes more than the car is actually worth. Worse than that, because the car keeps depreciating she will never catch up to the depreciation value until the loan is paid off. In the fourth year, it actually gets worse. Now, she owes $4,127.93 more than the car is worth. And so on…

What this means, in terms of total car cost, is that the same car costs more if you increase the length of the loan. By jumping for the 7 year loan at 9% instead of the 5 year loan at 7%, Susy-Becky is paying $89.71 less per month. But, she's also paying $2,919.30 more for the car. She was having trouble affording it in the first place, why would she be happy about paying an extra $3,000 for it? How much *extra* interest would you like to pay for a new car?

The reality is, of course, that you really can only afford a certain level of monthly payments. If you have $350 set aside for your car payment like Susy-Becky, then the $435.63 per month option doesn't work… right? **Wrong!** In this case, the problem is that the CAR doesn't fit your budget. You have to find a car that you can pay off in three years with payments of $350 per month. You have to live within your means, especially with an asset like a car that loses nearly a third of its value the first year.

Imagine how differently this might have gone if Susy-Becky had walked onto Felder & Mark's Big Time Auto Lot armed with the knowledge that she should have had in the first place.

On Saturday, Susy-Becky is desperately trying to wind down after another hard week at work. Her nerves are on edge. In the back of her mind, that mountain of paperwork looms, waiting for her to return to it on Monday. But, this weekend she has an advantage to help her de-stress. She's buying a car! No more bus. No more Bertha or smelly Pete. No more screaming Mr. Crabwick. Of course, that meant a little work on her part, but the thought of all the freedom she would have with a new car was enough to give her a smile despite all her problems.

Susy-Becky woke early and spent some time looking up cars on the Internet. She went to several dealership websites, looked up some information on <kbb.com>, and then called six dealerships to compare prices. She knew she only had $3,000 to put down and her budget really only would allow for a monthly payment of $350. Even that payment would be pushing the limits given that she would need to add the cost of insurance, gas, and maintenance. What sort of car could she afford for that amount? Well, $3,000 is one-fourth of $12,000 (which she learned is a good amount to put down on a car), so she started her search in that range.

After a few hours, she took a break. She'd learned a lot. She really liked the look of the Honda Civic, but it was just too expensive to fit into her budget. After some more searching, she'd settled on the Honda Fit, which also came in a cute lime green. She'd called several lots and asked a standard question: "Hello, I'm interested in buying a new Honda Fit, lime green with a soft cream-colored leather interior…do you have that car and what is your best price?" Three of the lots had come back with the $12,000 price point that was in her budget.

After her break, she made some more phone calls and visited the websites for several different Credit Unions and Banks. Some of them even had useful online tools to allow her to estimate loan costs by typing in some simple information! It was all working out so well. It was even fun in some ways, seeing how close she could get to the numbers that she wanted. Not like going out to Applebee's or anything, but it felt good to make the progress she wanted.

The best deal on financing that she found from the dealerships was at Felder & Mark's Big Time Auto Lot. They offered a 5 year loan at 7% with her credit score of 650. Balthasar Credit Union, where she had her savings account, did them one better, though. With $3,000 down, they offered her a loan for the remaining $9,000 at 6.5% for 5 years. Their loan department was even open on Saturday! It took some time to run down there, but once she was inside the people were very friendly and it only took her about an hour to get the paperwork all squared away. They contacted the auto lot to get the precise details of the car, and Becky was on her way with the loan paperwork in hand.

She had a little skip in her step as she walked onto Felder & Mark's Big Time Auto Lot, conveniently only four blocks from her apartment. F&M sure did have a ton of cars. It only took her a moment to find the car she'd chosen, the cutest little lime green Honda Fit. As soon as she saw it, a smiling salesman seemed to materialize out of thin air right at her elbow.

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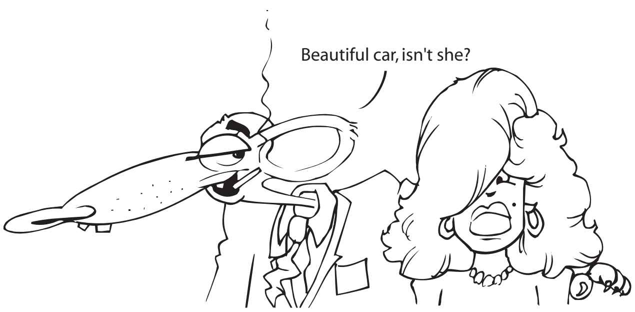

"Beautiful car, isn't she? She just came on the lot yesterday. Straight from the factory. We've had some calls about it, too," said the man with a friendly smile. Susy-Becky caught herself as she jumped, startled at the man's sudden appearance. He seemed nice, though, and he held out his hand in a friendly way. "I'm Terry. How can I help you?"

"Oh. Uh… Susy-Becky. I was the one that called about the Fit, actually," Susy-Becky started to say as she shook his hand. "I'd like to take care of the paperwork."

"Fantastic. Step into my office over here, and we can talk about it. I'd love to see you drive off in this car today."

"Alright," said Susy-Becky. She followed along, encouraged by the salesman's confidence. Inside, there was a comfortable and exciting air, the mingled scents of new car and coffee drifting about. Susy-Becky sat across from Terry and smiled back at him as he worked at his computer for a minute. After some small talk, Terry's assistant brought out some coffee.

"I'll be really happy if you're never at the mercy of that awful bus system again. What kind of payments were you looking to make on this car?" asked Terry.

"I already have the loan paperwork ready. Here it is," said Susy-Becky with confidence, pulling out the papers from her folder. "I'll be putting down $3,000 today along with the tax, tag, and title. The loan is from Balthasar Credit Union for the remaining $9,000. I believe they already talked to your loan officers."

"Oh. Right. Well… I'll get that taken care of," said Terry, looking more than a little out of sorts. He looked confused as he walked out of the office with the paperwork in hand. An hour later, Susy-Becky drove off the lot in her brand new Lime Green Honda Fit with payments of $176.10 per month, just a little more than half of the payment amount that would fit in her budget. She'd caught Terry by surprise, but he made the sale. Maybe his commission wasn't quite what he'd hoped for, but there was always another sucker.

That time, it went a lot better. There was virtually no negotiation at all because Susy-Becky walked into the situation with all the knowledge she needed. She was able to walk away happy and confident that she hadn't gotten a bad deal because she controlled the transaction. She had power as an informed consumer, and she used it. Incidentally, after 3 years Susy-Becky's Honda Fit will have depreciated 62% and be worth $4,560. At that point, she'll only owe $3,953.09 on the loan. She'll have $606.91 in equity to trade in on a new vehicle.

INSTRUCTOR TALKING POINT

Most Americans trade cars in after 3 years and the depreciation is high enough to cause the debt from the old car to be rolled onto the new car, increasing the amount of debt and, essentially, the cost of the new car.

For example: if you follow the trend of the average American who trades their car in every 3 years. Over a 9 year period, you'll have traded in three cars and allowed your debt to continually roll from one car to the next. The car loan you now have is so large that you have no chance of paying it off if you only focus on the monthly payments; it's the "American Dream." Don't allow yourself to be buried in debt, make sure you cover the debt of one car before you begin paying on the next.

How can you make this work for you? Trading in your car after three years means that you have 36 months of good payments in your payment history, which will build up your credit score (if you have been paying on time). Once you trade in this car and get a new loan, the old loan will be listed as "closed - paid in full." The new loan will be "open - paying as agreed." So, you have one loan for the value of the car closed, showing you *were* responsible and the new loan, showing that you *are* responsible. You also now have new credit, more available credit, and so on, all of which help your credit report and score. For more details on this, again, we encourage you to take Credit & Debt Management.

But, did she really get the best deal? Purchasing a new car was hardly Susy-Becky's only option. Let's take a look at two other choices that she might have made.

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Leasing a Car

To determine if a lease makes sense you need to determine two important factors. First, how many miles do you usually put on your automobile per year? Second, what is the total cost of the lease from the point you acquire the automobile until the point when you turn it in at the end of the lease?

Mileage

Think of a lease as a long-term rental agreement. You are going to rent the car for say three years. When you sign a lease agreement, you are obligated to use the automobile less than the defined annual mileage limit. If you exceed that limit there is an extra charge of typically 12 to 15 cents per mile, which is due immediately when you return the car at the end of the lease. If you sign a lease for a car and agree to use only 10,000 miles per year and you actually average 15,000 miles per year, you will have a very large expense when the lease is finished. If the fee is 13 cents per mile for extra mileage you'd be looking at an additional charge of $1,950. It's important to understand that you can negotiate a higher mileage agreement up front for significantly less money than if you pay the fee at the end of the lease. Make sure to get the actual mileage needed up front in the contract.

Total Lease Cost

When leasing a car, you are not paying for the car; instead, you are paying for the depreciation of the car during the term of your lease agreement. If we look at Susy-Becky's Honda Fit, it costs $12,000 brand new. If she leases it for three years, the depreciation will be 30% the first year, 18% the second year, and 14% the third year for a total depreciation of 62%, or $7,440 (this is the amount she would pay during the lease).

When you buy a car, you usually make a down payment which reduces the amount of money you borrow, thus lowering your monthly payment. When you lease a car, you put money down on the car to reduce the depreciation amount (called Capital Reduction), and it lowers your monthly payment. Down payment and capital reduction are different, but the effect is kind of the same: They both serve to lower your monthly payment. In our example, you are paying $7,440 in depreciation; you lower that amount with a Capital Reduction of $1,500 (similar to a down payment) to $5,940. The lease cost is $5,940 divided by 36 months, or $165 per month.

Add up the total cost of the lease by adding the capital reduction amount, all the monthly payments, as well as any turn-in fees which should be clearly listed in the agreement. Now you have the total cost of driving the car for three years.

Compare Buying to Leasing

Now compare the total cost of the lease to the total cost of buying the same car for the same time period. Remember that mileage must be the same so that you have an equal comparison. Also remember that you need to know what the resale value of the purchased automobile will be at the end of the term you will own the car. You can find a good estimate of the future resale value by looking at the NADA guide and figuring out the average depreciation schedule for the specific car.

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What about buying a Used Car?

Suzy-Becky had a third option when considering how to purchase an automobile. Used cars can be great for finding deals, but there is an old saying: Caveat emptor (Let the buyer beware). Doing your homework is even more important when purchasing a used car. You need to carefully consider what you are using the car for if using this option as well as the age of the car when you purchase it. If you buy a two-year-old used car, be aware that it has already depreciated 48% of its original value before you ever even lay hands on it. A used car can be a good option if you are the type of person who owns their vehicle for 5, 6, 7 years or more and likes to drive it into the ground before getting a new car, but DO THE RESEARCH!

Cars and trucks have changed a lot over the last 10 years. These days, almost every mechanical system is controlled by electronics. In fact, a typical two or three-year-old vehicle has more than 100 microprocessors, 50 electronic control units and 5 miles of wiring. What this means is that if you plan to buy a used car that's less than five years old and you think you can thoroughly check it out by taking it for a short spin and kicking the tires, think again.

Finding a reliable used vehicle works best as a three-step process that involves online research, a thorough initial inspection, and a final physical and computerized inspection performed by a mechanic. We'll discuss the first two steps so you can weed out the clunkers before spending money for your mechanic to do a final check. But, trust us: If you skip the final mechanic's inspection, it could cost you dearly. So, if you have your heart set on a particular make and model, start with step one before you go shopping.

Step 1: Check out your vehicle's reliability

Some makes, models, engines and transmissions are known for their high failure rates. Those are the facts you want to know before you start shopping. Some of the following sources charge a fee but may also be available for free at your local public library. Here's where to look for that information.

- **Consumer Reports ($30/year)** – Vehicle system reliability info based on actual readers' experience can be found here.
- **Truedelta.com ($10/90 days)** – Here's you'll find vehicle system reliability information along with actual repair costs incurred by owners.
- **Alldatadiy.com ($27/year) or eautorepair.net ($26/year)** – These up-to-date lists of technical service bulletins from carmakers disclose known failures, updated parts and repair procedures, and software fixes.

Step 2: Do your own inspection

Once you've selected a particular make and model and you go check out actual cars, here is a series of simple, quick things you can check out to eliminate possible problem cars. You'll need a few tools for this step. These include: a tread depth gauge, a digital volt ohm meter, brake fluid test strips, a flashlight, and a kitchen thermometer. Fortunately, all of these can be found at a good auto parts or dollar store relatively cheaply.

- **Check all the features -** Test every vehicle feature to check for proper operation: power windows, power locks, power sliding door and hatch, sunroof, power seat, heated seats, power mirrors, cruise control, all climate control settings, backup camera and sensors, keyless entry and remote start, and exterior/interior lights.
- **Do a bulb check -** Turn the key to the On position but don't start the vehicle. All the warning lights (icons) should illuminate to prove that the bulbs work. Consult the owner's manual to see which warning lights are installed on that vehicle. The most common is the "Check Engine" or "Service Engine Soon" light. But, also check for ABS, Brake, SRS (airbag), TPMS (tire pressure), OIL, HOT (or gauge), ESP/TCS (traction/stability), and Battery/Charging lights. Then start the engine. All warning lights should turn off. If not, there's a problem.

- **Check the dipstick -** Pull the engine oil dipstick and examine the color. A honey color is an indication of fresh oil – light brown indicates slightly used oil (both good signs). However, a chocolate milk color is a bad sign that may indicate a leaking head gasket – easily a $1,500 repair or more.
- **Check tire tread depth -** Using a tread depth gauge (not a penny); measure the tread depth in the center and both edges on each tire. The three tread depth readings on each tire should be within 1/32" of each other. A greater difference indicates an alignment, inflation or suspension problem. All four tires should be within 2/32" of one another. A greater difference indicates lack of proper tire rotation. Tires with a tread depth of 4/32" or less should be replaced (factor the cost of new tires into your offer).
- **Check engine coolant for electrolysis -** On a cool engine, remove the radiator or overflow tank cap. Using a digital volt ohm meter set the dial to the 2-volt DC scale. Then touch the negative meter lead to the negative battery post. Dip the positive lead directly into the coolant in the radiator or overflow tank. The reading should be less than 0.300 volts. If it's not, the coolant is worn out and there's a good chance that corrosion has already started to eat away at cooling system components. If the reading is below 0.300 volts, turn off all electrical accessories, start the engine and rev it to 2,000 rpm and repeat the test. If the reading rises, the vehicle has an electrical grounding problem that must be addressed. Wipe off the meter probes before storing.
- **Check brake fluid condition -** When brake fluid wears out, internal corrosion sets in and corrodes brake parts from the inside out. The corrosion process leaches copper into the brake fluid. You can test for the presence of copper by dipping a test strip into the brake fluid reservoir and comparing the color with the chart on the package. High readings indicate owner neglect and a high possibility of internal brake system damage.
- **Check for rust and paint blisters -** Check along the edges of the hood and trunk lid, rocker panels, bottom edges of doors and around wheel wheels. Look for any rough or raised areas that might indicate the start of serious rust issues. Sellers often mask rust problems with touch-up paint, so look carefully.
- **Test A/C performance -** Close the windows and doors and set the A/C to "Max" and "Recirculate." Insert a kitchen thermometer into the center air duct. Start the engine and rev to 1,500 rpm for several minutes. The temperature should slowly drop into the 40's (unless it's a very hot and humid day). If the temperature doesn't fall below the high 50's, the A/C system requires service.
- **Check for leaking CV boots -** Turn the wheels full left or right. Shine your flashlight at the CV boots on each end of the axle. If you see tears or grease, you're looking at a $400 repair.

- **Test-drive the vehicle -** The vehicle should start right up and idle smoothly. Acceleration and all shifts should be smooth; jerky acceleration or harsh shifts are trouble signs. Apply the brakes at highway speed and check for brake pedal pulsation, steering wheel shake, or pulling to one side. Also, drive the vehicle to a secluded area with flat pavement and drive for a short distance with your hands off the wheel. The vehicle should not pull or wander. If it does, that could be a sign of tire, suspension or steering issues.
- **Beware of seller's claims -** The most common mistake is to trust the seller's claim that "the car just needs this small fix." The truth is, if the problem were really that small, the seller would have fixed it already. What the seller means is: "I was hoping the transmission only needed a fluid change. Then the shop told me it was going to cost $2,000. So, I'm actually telling you what my first guess was and hoping you'll believe it." So, if a seller says, "It just needs this small fix," RUN!
- **Negotiate a price contingent on a mechanic's approval** - Consult *nada.com, kbb.com, edmunds.com* and *truecar.com* to find what buyers in your area are paying for the same vehicle. Then subtract the cost of any required repairs discovered during your inspection. You can't blame a private seller for asking full retail car-lot price for a used car. But, a fair market value for a used car from a private seller is halfway between trade-in and retail. So, that's where you should start your negotiations – at that halfway point. Then subtract the cost of discovered repairs. Once you and the seller settle on a price, make the deal contingent on receiving a clean bill of health (no more than $300 in additional repairs) from your mechanic.

Asking price: $7,855
Needs:
CV Boots - $400
Brake Job - $275
Tranny Fluid- $180

OFFER: $7,000

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Step 3: Get a professional inspection

Expect a professional mechanic's inspection to run to $125 to $200. A professional inspection can discover the early stages of problems way before they turn into costly failures. So it's worth it to pay for a full physical inspection and test drive along with a complete computer scan.

The computer scan can discover whether the seller recently cleared trouble codes to cover up a problem. A professional scan told can also check whether the vehicle's software is up-to-date. Software updates are critical to the proper performance of your vehicle, and unlike free software updates for your home and business computers, updating vehicle software costs about $200.

Carfax.com is a good resource to use as well. If any claims have been made on the car, they will show up on the Carfax report. This is only helpful if a claim was made on the car, though. If the previous owner damaged the vehicle but did not file a claim, a Carfax report won't help.

KPC. The key here is to have as much knowledge as possible so that you have the power to control the transaction. It's not always easy or possible to gain all the knowledge you need when dealing with a used car. It has, after all, been subject to someone else's driving and maintenance habits. Another old saying is: You get what you pay for. If a deal on a used car seems too good to be true, it usually is.

So, let's look at the three options all in one place to determine what would really be Suzy-Becky's best option. Remember that all the variables for each option needs to be the exact same so that you're making a fair comparison (apples to apples instead of apples to lugnuts).

Honda Fit			
	Buy New	**Buy Used**	**Lease**
Purchase Price 	$12,000.00	$7,000.00	N/A (doesn't matter)
Down Payment/Capital Reduction			
	3,000.00	1,750.00	$1,500.00
Three Years of Monthly Payments			
Loan from Balthasar Credit Union: $9,000 at 6.5% for a 5 year term with monthly payments of $176.10 ($176.10 x 36 months = $6,339.60)	6,339.60		
Loan from Balthasar Credit Union: $5,250 at 7% for a 5 year term with monthly payments of $103.96 ($103.96 x 36 months = $3,742.56)		3,742.56	
A $12,000 car will depreciate 62% in three years. $12,000 x 0.62 = $7,440.00 (this is the amount you are paying during the lease). In this example, you reduced the capital by $1,500, so... $7,440 - $1,500 = $5,940			5,940.00
Maintenance Costs			
We are assuming that the maintenance costs are going to begin by averaging the same amount over three years. Because the used car is older, we are adding 15% to the maintenance costs. The leased car includes oil and tire changes in the lease agreement, so those are excluded from the maintenance costs for our comparison.	6,010.00	6,911.50	5,110.00
Sales Value			
To keep the comparison accurate, we are assuming that you drive the car for three years and then sell it, if you are the buyer. The NADA guide would give you a value for your car of: full value - depreciation. We are also making the assumption that you can sell the car for the full NADA value (which is generous as in most cases you will not get the full value)			
In the case of the new car: $12,000 - $7,440 = $4,560. You also have equity in the car (you only owe $3,953.09). This adds to the value of the car as you can sell it for more than you owe, but the remainder of your loan must still be paid off. The remainder is your profit on the sale. $4,560 - $3953.09 = $606.91	606.91		
In the case of the used car, the car had already depreciated 48% before you bought it (it was 2 years old). Over the 3 years that you owned the car, it depreciated an additional 33% for a total depreciation of 81% from the original value of the car. ($12,000 - $9,720 = $2,280) You still owe $2,321.87 on your loan, meaning you are "upside down" on your payments (you owe more than the vehicle is worth). The difference between what you owe and what the car is worth must still be paid. $2,280 - $2,321.87 = $-41.87		-41.87	
In the case of the leased car: You are only paying for the depreciation of the car over the time you are using it. So, there is no resale value as you will be returning the car at the end of the lease term.			N/A
Total Cost			
Total Purchase Cost: New Car:	**$14,742.69**		
Total Purchase Cost: Used Car:		**$12,445.93**	
Total Leasing Cost: Leased Car:			**$12,550.00**

In our example, to lease the Honda Fit cost $12,550.00, buying it new cost $14,742.69, and buying it used cost $12,445.93. You drove the car the same mileage, completed the same maintenance schedule, and sold or turned the car in (at the end of the lease) in the exact same condition. By buying used you saved $2,296.76 over buying new and $104.07 over leasing. So, it makes more sense to buy a used car, right?

The answer to that question is, of course: It depends. Should you buy new, used, or lease a car? That depends entirely on *your* driving habits and *your* needs. Are you going to pay the car off in five years or less, and plan to own and drive it for more than three years? Then buying the car new is the best choice. If you like to drive a different car every three years, like most Americans, then leasing is probably going to be the best choice for you if you can be sure to keep to a specific amount of mileage. If you're willing to do more research and tend to drive your car for more than five years, you may want to consider buying used. Now you have the formulas to figure it out for yourself!

Money Saver! Ultimately, you want to drive the best possible vehicle at the lowest total car cost.

Chapter 5 - Finding a Home

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We all need a place to live when we leave prison. Some of us may start off by living with a family member or a friend until we can get on our feet. Others will live at a shelter or half-way house. Still others will be able to find an apartment to rent, maybe with one or two roommates. Then, there are those of us who are financially able to buy a home of their own. Each of these options has advantages and disadvantages, and each of us has to face the reality of our own situation.

No matter which option we choose, where do we start? Let's look at some of the options we face, so that we can gain that first step in the **KPC**'s (knowledge).

Staying with a Family Member or Friend

This option is likely to be the cheapest alternative. You may be allowed to live rent-free, or at a token amount, while you get back on your feet financially after your stay in prison. With discipline, you can use an opportunity like this to rapidly save money towards a place of your own, be it an apartment or a house.

If this is available to you, it may be the best way to start. Assuming that you don't have a probation officer to place restrictions on you, this is the option that will likely offer you the most freedoms. You can come and go as you please. On the flip side, going to live with Mom (or your sister or friend) may place a strain on that relationship. Both you and they will have to readjust to the new situation. This option, therefore, works best as a temporary situation.

Living at a shelter or a half-way house

There are several types of shelters – overnight shelters, "regular" shelters, and halfway houses (Some examples: Salvation Army, the YMCA, and Ken Cooper Ministries). Each is a little different from the other. Of course, there are many beyond these three. You'll need to contact your classification officer or someone on the outside for additional information.

These will likely be cheaper than renting or owning your own place. But, there will likely be some basic rules of the house that you will be required to follow—curfews, cleanliness standards, no alcohol, and so on. These types of living arrangements are also not designed to be permanent. They'll expect you to find a place of your own after a while.

For those of us who have the option to find a place of our own, we have two basic choices (just like when purchasing a car) – buy or rent. Let's look at each in detail.

Renting a Home

Unless you are absolutely certain that you won't want to move within the near future, renting will probably be your best option. For those of us who can't afford a house right away, renting will often be our first step toward that goal, as well. You won't get pride of ownership, nor tax deductions, nor build up equity, but renting may be the reality of our budget and can be a desirable way to live. The responsibility of general maintenance lies with the landlord. If you need or want to move, your only obligation is the length of your lease (and even that may be negotiable). Even with the initial move-in costs, it requires far less of an investment than buying a home. But, it still requires financial planning.

How much can you afford?

This will be among the first questions you must answer for yourself. You must have already applied the lessons on making a budget and living within it. If you decide you need to split the rental cost with a roommate or two, will you be able to live up to the lease obligations if they move out or can't (or won't) pay? You need to know the answer to these questions so you don't suddenly find yourself homeless. You also need to consider the costs of just moving in.

Remember our chapter on budgeting? We said that you want to allow 20 to 35% of your take-home income for housing. In our Taco Bell example, we worked a few extra hours and did a job on the side during the weekend to increase our income. Our take-home pay was $1,540.38. That means that I can allow between $308.07 and $539.13 for my monthly housing expenses. That's not going to get us a penthouse suite in downtown Tampa. It might get us a small studio/efficiency apartment. In our example, we leased an apartment for $1,000 and took a roommate to split the rent, each paying $500. That falls within our range ($500 is 32.5% of our take-home pay), but there are other things to consider as well.

As with all our finances, your credit rating is very important here. You'll also need to have an established relationship with a bank (at least one account). This demonstrates stability. The landlord and lender will want to know about that stability as well as if you can and will pay on time, every time. So will the utility companies who control your power and communications. If a credit check shows that your expenses are greater than your income can support, you likely won't qualify.

Make sure you pay your bills on time and in full every month.

Do everything you can to repair and build your credit rating. If you haven't taken Credit & Debt Management, it is an excellent resource to help you do this, and you can start while you are right here.

What if your credit score is low?

Some landlords will flat-out refuse to rent to you. Others will want a significant security deposit along with the first and last month's rental deposit. If you have an excellent credit rating, some landlords may forgo the rental deposit and/or the security deposit, or they may require significantly lower securities.

Are you financially prepared?

This doesn't only involve your credit rating and bank account. There are other things to consider as well. If you do not rent a furnished apartment, for instance, you will have to purchase your own furniture. How about pots and pans to cook in if your apartment comes with a kitchen? You'll probably need cleaning supplies. There are a lot of expenses to consider when you think about moving into an apartment.

Before you move in:

The odds of finding an apartment that includes utilities are much lower than they once were, and this can be a significant expense. The security deposit you make on your utilities will vary from company to company, from location to location, and with your credit history. Some utilities will return your deposit even while you're still a customer if you maintain a good record in paying your bills. That good record can follow you from utility company to utility company as well. Whatever your payment history is like, you will need to contact the utility companies and arrange an account with them before you move in.

Typically, a landlord will require three months' worth of rent before you move in (first month, last month, and security deposit). This can add up to a significant sum of money. In our Taco Bell budget example, we were splitting the rent with one roommate. The actual rental cost is $1,000/month. That makes the move-in costs owed to the landlord $3,000 (first month $1,000+ last month $1,000+ security deposit $1,000= $3,000). In our case, if we were moving in with the roommate already arranged, we would be able to pay $1,500 each in deposit money.

INSTRUCTOR TALKING POINT

So, first and last month's rent and a security deposit... Does that represent everything you'll have to pay for when you move in? We mentioned utilities. You'll also need to include money to turn the lights on. What about pots and pans to cook with? Are there appliances in the apartment? If not, you might need a refrigerator and a stove. While on the subject of appliances, it's important to bring up the possibility of replacing them with the landlord (in case you ever want a better stove or refrigerator). Even if the apartment comes with the basics, what about a microwave or a toaster? How about a sofa and a bed? A TV? A lot depends on whether or not you're renting a furnished apartment or not. It can be a financial advantage if you rent an apartment with furniture already in it, but bear in mind that that furniture doesn't belong to you any more than the apartment does. Not only can't you take it with you, you become responsible if it gets damaged (outside of normal wear and tear) and needs to be replaced. There are a lot of costs associated with renting that you need to keep in mind. In our example, if we were not renting a furnished apartment, our expenses might look more like this:

[ASK THE CLASS FOR THEIR OPINIONS ON COSTS - WRITE THE FOLLOWING ON THE BOARD (ALTERING THE PRICES IF THE CLASS COMES UP WITH A DIFFERENT AMOUNT. THESE ARE MINIMUMS]

Move-in Costs	
First month's rent	$1,000.00
Last month's rent	$1,000.00
Security Deposit	$1,000.00
Furniture	$1,800.00
Pots and pans	$150.00
Dishes, cutlery, and glasses	$150.00
Cleaning supplies	$80.00
Vacuum and mop	$80.00
TV (with stand)	$500.00
Utilities (Electric, water, trash removal)	$250.00
Food (1 month)	$250.00
TOTAL:	**$6,260.00**

Note that the move-in costs more than doubled. Always take into account all your costs for moving in. Do you have a pet? Add another deposit to that amount, and don't count on getting your security deposit back.

When you first rent a property, take a tour with the landlord and document with photographs the exact condition of the property before you sign the lease. When you move out, make sure the property is in at least as good condition as when you rented it if you want to get your security deposit back. The landlord can withhold all or part as necessary to make the property rentable again. If possible, make a final inspection tour with your landlord (with the original photographs you took) before you move out. If there is serious damage, you may not only lose all of your deposit but you may even owe more. You may even be sued by the landlord. This will make future rentals much more difficult and should be avoided at all costs. When renting an apartment, treat it like it is someone else's property. Because it is.

How can you protect yourself?

One of your first considerations when renting a new property should be the safety and security of both yourself and your possessions. An alarm system might be a good idea, but make sure it's allowed by your lease. It may be expensive and it may not be removable when you leave. Regardless, make sure your landlord changes the locks on ALL the doors and that you and the landlord are the only ones with copies of those keys. I know it sounds crazy, but some people aren't honest and others might be criminals. Former tenants will sometimes keep copies of the keys for their old locks and come back or sell the keys to burglars.

Even if you don't own the building, there are still things you do own and want to protect inside it – electronics, books, clothes, CD's, software, jewelry... whatever. You also have some liability for accidents that might occur in the property under your control. To protect your things and yourself, Renter's Insurance is a great idea. We'll talk more about insurance later, but it is a major advantage for a generally minimal cost.

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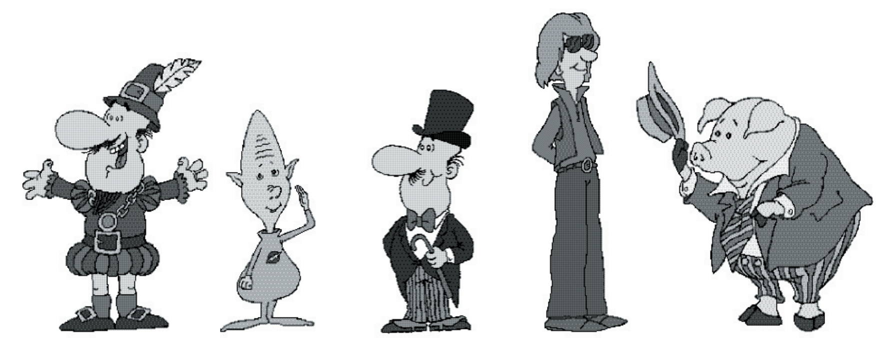

Who would you like as your roommate? The good news is that, on the outside, you get to choose.

Of course, if you are sharing an apartment with a roommate make certain that you vet that person to be as sure as you can be that they are financially trustworthy (at least). You may also want to consider whether or not they are clean, lazy, or whatever characteristics you find important. You'll have far more privacy in an apartment than you do here in prison, but you'll still be living in close proximity with this person. This time, however, it's your choice to do so. It's important to make sure that the person you choose to live with you is a good fit for your lifestyle.

By far, the most important thing you can do to protect yourself when renting an apartment is to READ the lease before you sign it. As with any contract, it is going to have a lot of fine print. You need to understand all of it (and how it relates to you) BEFORE you agree to sign it. It's okay to take your time. Once your signature is on that piece of paper, you are legally bound by the terms.

Items to think about when looking for a rental unit:

- How many bedrooms, bathrooms, and closets does it have? What is the square footage? Is this sufficient for my needs?
- Are the appliances gas or electric? This can affect your utility costs.
- What kind of flooring does it have? Some floors are more susceptible to damage or stains.
- Do all the plumbing fixtures and appliances work?
- Is the location near where you work? Is it near public transportation? What about parking or schools?
- What is the condition of the walls and ceiling? Look for water stains or obvious cracks.
- Is the unit furnished or unfurnished? Remember that this affects our move-in costs.
- Is there central heat and A/C or are window units allowed?
- Is the area quiet and secure at night?
- Do all the windows open and close easily? Are the screens in good condition?
- Is there easy access to shopping, parks, and recreation?
- Are there sufficient electrical outlets, phone jacks, and cable connections?
- Are Laundromat services available?

How to find a place to rent:

There are many ways, but the best, as always, is on the recommendation of family and friends. They will usually give you the most objective opinions and will generally be speaking from their own experiences. Sometimes, referrals will get some sort of discount from the landlord.

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Searching online is a great first step to do some research. There are a lot of useful sites and apps (such as *Zillow.com, Trulia.com, Apartment.com*, and *Rent.com*) to help do this. Local newspapers also still run rental ads in the classified section at least once a week. They also often maintain more extensive lists on their websites. Don't just check the major papers, either. Check out the weeklies and neighborhood papers as well. The downside of resources using either papers (and even more so the Internet) is that they get viewed by many, many people. So, competition for these properties can be fierce.

Local businesses like coin laundries, restaurants, and grocery stores also often have bulletin boards with rental listings posted. Real estate agents can be another source, and there are agencies that specialize in rental properties. They can be an excellent resource, but they tend to work on commission and will recommend the most expensive properties. Some will also want you to pay a finder's fee for their services.

What to look for in a lease:

A lease can be a little confusing for the average person. We keep mentioning this, but read all of it carefully, including (and especially) the fine print. Once you sign it, it's a legally binding contract.

- Look at the move-in date to be sure it's what you want
- Check the length of the lease. It is usually six to twelve months. Is the period too long or too short for your needs? During the lease, your rent should remain stable. Will the rent increase when the lease expires? Will renewal be automatic?
- How much is the security deposit?
- Are pets allowed? Are children allowed? Do either require an additional security deposit?
- What is included – water, electric, garbage, cable, use of recreational facilities, etc.?
- What changes are allowed by the tenant – hanging pictures, wallpaper, painting the walls, etc.?

- Specific landlord obligations – scheduled maintenance, emergency maintenance, repainting, shampooing carpets, changing filters, etc.?
- Be aware of all the rules about potentially subletting the property, termination of the lease, landlord access, etc.
- Be sure all parties have signed and dated the appropriate spaces. Leave nothing blank on the lease. If a section does not apply, fill in "Not Applicable" or "N/A." If any parts are or can be changed by consent of both renter and landlord, both should initial any such changes. See if the document should be notarized. Do not sign a lease with blank spaces.
- If there is no written lease, the span of your rental payment (weekly, monthly, etc.) determines the length of the agreement.
- Ask for clarification of any language or terms you do not understand.
- Be wary of "waiver provisions" that might affect your rights.
- Do not sign a lease that allows the landlord to show your property to potential renters while you are still living there.
- Be aware of your rights as a renter if the landlord sells the property.

8 Questionable Rental Fees To Look Out For:	
Excessive late-rent fees	Redecorating or cleaning fee
Overnight guest fee	Administration or processing fee
Unnecessary application fee	"Non-refundable deposit"
Repair fees	Finder's or Holding fee

For reference, there is a sample lease agreement located in the appendix of this book.

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Renter's rights and responsibilities:

A tenant is entitled to the right of private, peaceful possession of the dwelling. Once you rent it, it is yours to lawfully use. The landlord may only enter the dwelling in order to inspect the premises or to make necessary or agreed upon repairs, but only if he or she first gives the tenant reasonable notice and comes at a convenient time. If an emergency exists, the requirement for notice may be shortened or waived.

Florida Statutes, Section 83.51, require a tenant to comply with the local Property Maintenance Code. This means that you must:

- Keep the house or apartment in a clean and sanitary manner.
- Remove all garbage from the house or apartment in a clean and sanitary manner (using garbage cans, for example).
- Keep all plumbing fixtures in the house or apartment in a clean and sanitary manner and in good repair.
- Properly use and operate all electrical, plumbing, sanitary, heating, ventilating, air conditioning and other facilities and appliances, including elevators, which are in the apartment or house.
- Not destroy, damage, or in any way misuse the property itself. This includes not permitting any of your guests to do so either.
- Not remove anything from the house or apartment which does not belong to you (for example, you can't remove light fixtures that were in the property when you moved in).
- Conduct yourself, and require anyone who visits you to conduct themselves, in a way that does not disturb the peace.

Landlord’s rights and responsibilities:

The obvious right as a landlord is to receive rent for the use of the property. Another important right is to have property returned undamaged at the end of the agreement. It should be returned in the same condition in which it was received, except for ordinary wear and tear. The landlord also has other obligations, including:

- Meet applicable housing and health codes
- <u>Maintain the building in good repair</u>
- Install and maintain smoke detectors

INSTRUCTOR TALKING POINT

The tenant has the right, under certain very aggravated circumstances caused by the landlord’s neglect, to withhold rent. This can *only* be done when the landlord fails to comply with an important responsibility, such as providing a safe and habitable home in compliance with local housing codes. Before rent is withheld, the tenant must give the landlord seven days written notice of the problem so the landlord can fix it. Even after withholding rent, the tenant should save the money aside and seek court permission to spend part of it to do what the landlord should have done. If the tenant does not preserve the money and seek court assistance, the tenant may be evicted for nonpayment.

There is a complete copy of the Florida Statute regarding the landlord’s obligations in the appendix of this book.

Common Renting Errors:

- Do not rent unless there is a lease. Should you do so; local and state statutes will govern the arrangements
- Do not rent property that is damaged until all repairs are made. This applies to water damage from leaks, stains, plumbing, appliances that don’t work, etc.
- Be wary of subletting your property, even if the lease allows it. You are still responsible for any damages to the property.
- Do not sign a lease that makes you responsible for maintenance and repairs on the apartment beyond normal wear and tear.
- Be aware that improvements you make to the rental property may not be reimbursed by the landlord and may be kept by the landlord.

Always remember that whether you are buying or renting, the same three classic principles of real estate will determine price – **location, location, location**.

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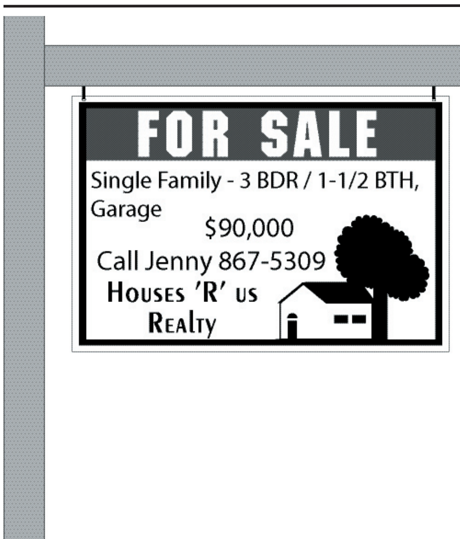


Buying a Home

To put it mildly, purchasing a home is a little more complicated than renting.

How much can you afford?

For most of us, a home will be the biggest asset we ever purchase.
Therefore, the mortgage loan, for most of you, will be the largest amount of
money you ever borrow. It is very important that you borrow that money at
you even begin to look for a home, you have to get very serious about getting
ter your financial situation, the better your credit score will be, and the lower
obtain. Just a one percent difference on the interest rate (7% vs. 8%) will
.35 over the life of a thirty year $100,000 loan.

In order to get the lowest possible cost on your mortgage loan you need to understand how mortgage lenders make their loan decisions. Once you understand their requirements, you can get your finances to match or exceed their expectations and that will mean a lower interest rate and considerable savings.

When making a mortgage loan, lenders are concerned about two types of risk with respect to the borrower and collateral:

- Will you be unwilling or unable to make the monthly payments required by the debt agreement (the mortgage note)?
- Will the value of the collateral for the loan (your home) be adequate to pay off the remaining loan balance if you default and the lender forecloses on your property?

Lenders use the following loan underwriting standards to judge whether they want to grant you a mortgage loan on a one-to-four family residential property (single family home, town home, condominium, duplex, and triplex):

1. You must have a satisfactory credit report and your records must indicate that you have paid your debts on time.
2. You must have a satisfactory employment outlook, and demonstrate that you hold a reasonably stable job. Your employment records should not show a high frequency of job changes or periods of unemployment.
3. You must have an adequate income that is more than sufficient to pay all of your monthly bills, plus the mortgage payment. To make this assessment, banks employ several payment-to-income ratios. (We'll take a closer look at this later.)
4. The home that serves as security (collateral) for the loan must have a market value that will accommodate your requested loan-to-value ratio (e.g., 80 or 90%). Additionally, the home must have a high probability of maintaining its value in the future so that, if you default several years after the origination of the loan, the home's value will exceed the remaining loan balance.

Collateral

Property acceptable as security for a loan or other obligation.

Debt-to-income ratio

A lending institution will not lend money to you if your debt ratio is too high. In other words, if you owe too much money out to other companies, they are unlikely to grant you additional debt for fear of not being able to be paid back. Even though you may have every intention of paying them, they will not take that risk.

So, what can you do to ensure that you will get the money you need to buy the home? There are two rules of thumb that lending institutions go by. The first is called a payment-to-income ratio. This one is simple. Whatever your mortgage payment will be, it needs to be no more than twenty-five percent of your take home pay. In our third budget example from chapter one, we had a job as a machinist taking home $2,753.27 per month. So, our mortgage payment should not exceed $680.89 per month ($2,753.27 x .25). If your proposed mortgage payment exceeds this amount, the bank will seriously consider whether you have too much debt and may not approve your loan.

The second method is called the debt-to-income ratio. With this method, you take your entire debt service load (mortgage payment, car payment or payments, credit card payments, furniture payments, and so forth) and it cannot exceed forty-five percent of your take home pay. This doesn't include monthly bills like phone or electric, only lines of credit (also called "installment debts"). Using our machinist budget again, our take home was $2,753.27 per month. So, our total debt load cannot exceed $1,238.97 ($2,753.27 x .45). Unless you can meet both the debt-to-income and payment-to-income ratios, it is unlikely a bank will consider your loan application. In this example, you would be allowed a $1,238.97 per month for bills, including $680.89 for a mortgage payment, leaving $558.08 for the rest of our installment debts. In our example, we have a car payment of $256.94. This means that my remaining debt payments can't exceed $301.14. If we owed credit card payments of $302 per month, we would be over that limit.

Job #3		
Machinist $18.50 per hour		
40 hrs/ Weekly Income		$740.00
(times 4.33)		
Monthly Income		$3,204.20
Less Withholding 15%		($480.63)
Net Pay $2,723.57		
	Expenses:	
27.5%	Rent	($750)
13%	Food	($350)
5.5%	Clothing	($150)
11%	Savings	($300)
9.2%	Utilities	($250)
2.9%	Probation	($80)
20.6%	Transport	($561.94)
	Lease Payment	($256.94)
	Gas/Oil	($150)
	Insurance	($150)
	Repairs	($5)
10.3%	Discretionary	($281.63)
100%	Total	($2,723.57)

Payment-to-Income Ratio's

Monthly PITI
Must be < 25% of monthly net income

Monthly PITI + Other monthly obligations
Must be < 45% of monthly net income

(PITI = Principal, Interest, Taxes, and Insurance)

Before you even go to the bank, you can roughly figure out how much of a house payment you can afford by using these ratios. But, the question still remains, how much of a loan can you afford? The answer to that is actually fairly simple. The formula has two steps that look like this:

(Loan Amount) ÷ $1,000 = (# of Thousands of Dollars)

(# of Thousands of Dollars) x (The Factor) = (Monthly Payment)

Let's plug in the numbers on the next page.

For our example, we are going to consider a home that we want to purchase that costs $112,500. We are going to put 20% down, or $22,500, so the amount we need in a loan will be $90,000. We'll finance the loan for thirty years and the rate offered by the mortgage company is 8%. Here's the formula to figure out the payment:

______________ ÷ $1,000 = ___________ x ___________ = _______________

Loan Amount **# $1000's** **Factor** **Monthly Payment**

Monthly Payment per $1,000 Loan Amount		
Rate	15-Year Factors	30-Year Factors
5.5%	8.17	5.68
6%	8.44	6.00
6.5%	8.71	6.32
7%	8.99	6.66
7.5%	9.28	7.00
8%	9.56	7.34
8.5%	9.85	7.69

We're borrowing $90,000. So, we divide $90,000 by $1,000 ($90,000 / 1,000) = 90. Ninety represents the number of $1,000 units we are borrowing. Now we look up the factor. The interest rate the mortgage company is offering is eight percent on a fixed rate loan, so we look up 8% under "Rate" on the chart. There are two columns, a "15-Year Factor" and a "30-Year Factor". Our loan is for thirty years, so the factor is 7.34. Now, we have the numbers needed to figure out our monthly mortgage payment.

$90,000 ÷ $1,000 = 90 x 7.34 = 660.60

INSTRUCTOR TALKING POINT

Note that this calculation can also be done backwards. If you have an idea of the monthly payment you can afford, you can do this:

$660.60 ÷ 7.34 = 90 = $90.000

Monthly Payment ÷ Factor = # $1000's Loan Amount

You can use this to work out exactly how much you can afford to borrow in your home loan and what sort of interest rate you need.

Loan Amount **# $1000's** **Factor** **Monthly Payment**

That is a rough estimate of the amount that our mortgage payment will be. However, be forewarned, that this amount is principle and interest only. It does not include the additional costs that many lenders include in the mortgage. For instance:

When you purchase a property, the lender will require an inspection by a professional, because the lender does not want to loan money on a property that is not worth the amount being loaned. We'll talk more about this later, but you must be prepared for the inspector to potentially return a report that will not result in the loan not being approved. In other words, the bank may refuse the loan regardless of your willingness to buy the property.

Property taxes, an issue taken care of by the landlord when you rent, become your responsibility when buying a home. You will need to either have them withheld in your house payments or save money to pay them yourself (usually the lender will require that it be withheld). Sometimes, you'll need to do both (if the lender does not hold enough in escrow to cover changing tax rates). Owning a home means needing to be very aware of state and local elections, changing tax rates, and changing zoning laws.

If you are a homeowner, your lender will require you to carry Homeowners' insurance to protect *their* investment against loss by fire, flood, etc. Protecting *yourself* against the loss of the contents, lawsuits by anyone injured on your property, and other potential hazards, will be up to you. Again, we will discuss this in more detail later, but just like buying a car means considering the cost of insurance, buying a home must mean considering the cost of homeowner's insurance.

Can you afford $660.60 per month as a mortgage payment using both the debt-to-income ratio and the payment-to-income ratio? In our machinist example, we could. If not, you can "play" with the numbers to figure out approximately how much you *can* afford.

INSTRUCTOR TALKING POINT

Before we go much further, you need to understand the primary and secondary mortgage markets. If you understand how a mortgage trades, and how Wall Street values it, you will have a better understanding of how the mortgage application and underwriting process works. The more you understand (**knowledge**), the better candidate you will be (**power**), resulting in a better cost to you (**control**).

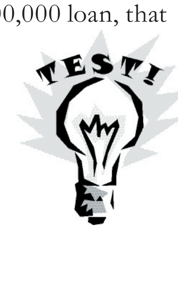
The market for home mortgage loans is split between the "primary mortgage market" and the "secondary mortgage market." That sounds fancy, but what does it mean? The "primary market" is the loan origination market, where borrowers and lenders negotiate mortgage terms. In other words, the primary market is you getting a home mortgage loan from your bank. There are many different institutions that supply money to borrowers in the primary mortgage market, including savings & loans, commercial banks, credit unions, and mortgage banking companies. Some of these options are better than others, depending on your situation. **Savings and Loan Associations** traditionally specialize in making single-family home loans based on time and passbook deposits. In recent years, they are branching out to deal with multi-family and commercial mortgages. **Commercial Banks** are the most common lenders for mortgages and where most people go for their financial needs. Just like with buying a car, **Credit Unions** are usually going to offer you more favorable terms. **Mortgage Banking Companies** play an important role in the market, too. They often take advantage of the many federally subsidized programs available, especially for first time home buyers.

Mortgage originators (such as banks or credit unions) can either hold the mortgage loans in their own portfolios or sell them in the secondary market. Most banks don't want to hold mortgage loans in their portfolios because it ties up their capital. Why is that? Think of it this way: If Acorn Bank has $1,000,000 to loan and a customer borrows $100,000 to buy a home, the bank now only has $900,000 left to loan. Acorn Bank could make nine more $100,000 loans, and it would then be out of money to lend. The bank does **not** want to be out of money. Having all their money tied up in loans means that they don't have that money available to invest and make a larger profit. It also prevents them from gaining any new customers. So, the bank has a problem here.

Here's how they solve it. Acorn Bank lends a customer $100,000 to buy a home, and then sells that loan in the secondary market for a fee. The bank gets the $100,000 back to loan again, and again, and again, each time making a nice fee for finding and originating the loan. Acorn Bank, instead of using the $1,000,000 to make ten loans can now make *hundreds* of loans. The largest purchasers of residential mortgages in the secondary mortgage market are the Federal National Mortgage Association, "Fannie Mae", and the Federal Home Loan Mortgage Corp., "Freddie Mac."

Here's the challenge for the banks and therefore for you. Fannie Mae and Freddie Mac have loan standards – they will only buy a loan from a bank if both the borrower's financial situation, and the loan amount meet their minimum standards. That's where those payment-to-income ratios we talked about came from. They refer to this as "conforming" or "non-conforming."

A conforming loan is one that meets the standards required by Fannie Mae or Freddie Mac in order for them to purchase it in the secondary market . You want your loan to conform to those standards because it costs less for you. Conforming loans are easier to buy and sell in the secondary mortgage market, and they carry a lower interest rate than non-conforming loans. Fannie Mae and Freddie Mac's standards state that the loan must not be more than a certain percentage of your income or exceed a certain amount on a single-family home. Over the last decade, the interest rate advantage for conforming has been about one percent. On a $100,000 loan, that equals a monthly savings of $68.46 (on an 8% rate loan). $68.46 per month over 30 years is $24,645.60 extra that you would pay if your loan *didn't* conform. <u>Loans that do not satisfy these standards are called "non-conforming loans."</u> With non-conforming loans, the bank must hold the loan in its own portfolio, so the bank will charge you more money for that loan. You want to conform!



Are you financially prepared?

Once you know what sort of loan you can afford, you need to know if you can actually qualify for it. Pre-qualifying is simply arranging financing before you go home shopping. Basically, you will go into your bank or credit union and apply for a loan. It is important to tell the lender that you are pre-qualifying, because for an actual loan application, they will wish to know what property you are buying. The lender will then run a credit check on you and pull up your credit history. They will also ask you to list all your debts (rent, car payment, credit card bills, and so forth that have a regular payment) as well as other bills. Then, they'll approve you for a certain amount. Their methods are very similar to what we discussed in the debt-to-income ratio section. This will give you a concrete idea of what sort of homes you should be looking at.

If you want to figure out if you are ready to buy, use the decision-making process:

Planning and goal setting:

You will want to carefully consider your current financial situation. What is your credit history and credit score? What is your current ability to pay monthly costs? There are websites you can use once you are out of prison to help. Hands-on-Banking, for instance, offers a checklist of things to consider before deciding if you are ready to buy. (*http://www.handsonbanking.org/htdocs/en/y/#/en/y/si/wea/ysiweardy.html*)

Making the decision:

You should have already made a monthly budget. Look at it and see if buying a house will fit into your financial plans. Don't forget the expenses associated with a house, such as: insurance, property tax, utilities, repairs, and other needs that might arise. Remember that it's not simply a matter of being able to afford the mortgage payments.

Assessing outcomes:

Is buying a house a good idea right now? If not, will it be possible in the near future? What do you need to do to accomplish this goal?

Always keep **KPC** in mind. But, be prepared for what it shows you. It doesn't help to have knowledge if you don't use it wisely. When buying a home, take a hard, honest look at your budget. If a home won't fit into it right now, then it won't fit. Ask yourself what you need to do in order to reach that goal and begin working toward it, but do not take a step that you aren't prepared to take. Taking on the kind of debt involved in purchasing a home without being able to handle that debt is like committing financial suicide. If you can handle the debt, there are still other things to consider...

Before you move in:

There are a number of things that will need to happen before you can move in and before the lender will even agree to the loan. Almost all of them will cost you money or affect the value of the house itself.

Down Payments

We've already discussed what kind of finances we'll need in order to make the mortgage payments themselves. One other major financial factor in purchasing a home is the down payment. The requirements for a down payment will vary between lending institutions. Some might not require any down payment at all. What's important to keep in mind is something that we mentioned in passing before: loan-to-value (LTV) ratio. The loan-to-value ratio is a measure of how much the loan amount is compared to the market value of the home. For example, if a loan of $80,000 is obtained against a property worth $100,000, the loan-to-value ratio is .80 or eighty percent. The higher the LTV ratio, the greater the payment.

In other words, the lender wants to see at least 20% of the loan covered before they'll loan you the other 80%. If you're buying a $100,000 home, they'll be looking for a $20,000 down payment. You can use collateral (say a piece of property) worth $20,000 to cover this, but, either way, this is the golden number they are looking for. Without 20% down (or in collateral), some lenders may still approve the loan, but they'll require something called **PMI**, or Private Mortgage Insurance. This adds $25-$50 to your payments each month and does absolutely nothing for you. All **PMI** does is insure the *BANK*'s interest in the loan. In case you default on your payments and they have to foreclose, **PMI** covers the 20% that should have served as your down payment. To put it another way, the bank will require you to pay for their insurance so that they don't lost money.

Why 20%? It's not a random number. Lending institutions, believe it or not, don't like to foreclose. Foreclosing generally means that they take a loss on the transaction. Not only are they not getting money from you

INSTRUCTOR TALKING POINT

There is so much that is costly and disadvantageous about PMI for the home buyer. Remember that it does nothing for you and everything for the bank. It exists to cover *THEIR* interest in the loan. In other words, it provides the bank with the money you should have put down (that 20%) if you should default on the loan.

This is what is supposed to happen with PMI... Once your loan-to-value ratio gets to 80%, the bank is **supposed** to stop charging you PMI. The bank would have to do a new appraisal on your home in order to know that the value of your home has gone up, right? The bank is NOT going to go to that expense just to save you money, though. Let's assume you have a home valued at $125,000 at the time you purchased it. You, like most Americans, could only come up with 90% of the down payment or $12,500. So you took out a loan for $112,500 at 5.5% interest. Let's assume you're in a rising economy and that real estate is increasing a nominal rate of 3% per year. Your loan-to-value ratio would look like this over the years:
[**WRITE OUT CHARTS ON THE BOARD AS YOU DISCUSS**]

Balance at end of the year	Home Value	Loan Balance	Loan-to-Value Ratio
	125,000	112,500	90.00%
1	128,750	110,985	86.20%
2	132,613	109,384	82.48%
3	136,591	107,692	78.84%

Your PMI should stop in the third year of your loan because your home has gained enough value to make the loan-to-value ratio better than 80%, but the bank does not automatically do a reappraisal on your home. To put it bluntly, it's not their job to keep up with the value of your home.

So what ACTUALLY happens is that the bank waits until the value of the home **at purchase** equals better than 80% loan-to-value ratio. As you can see by the chart below, that doesn't happen until year eight.

Balance at end of the year	Home Value	Loan Balance	Loan-to-Value Ratio
	125,000	112,500	90.00%
1	125,000	110,985	88.79%
2	125,000	109,384	87.51%
3	125,000	107,692	86.15%
4	125,000	105,906	84.72%
5	125,000	104,018	83.21%
6	125,000	102,024	81.62%
7	125,000	100,098	80.08%
8	125,000	97,883	78.31%

What does this mean to you the borrower? It means you paid PMI for an extra five years that you didn't need to. How much money are we talking about here? Well the average PMI payment is $25 to $50 per month. Going from the low end $25 that means that you would have paid $1,500 more than you needed to. I don't know about you but that $1,500 to $3,000 is better in my budget than in the banks.

So how do I keep the bank from taking that money out of my budget? The best way is not to buy a home until you can put at least 20% down. If not, then you have to keep up with the value of real estate in your area and have your home appraised by a professional appraiser when it has reached better than an 80% Loan-to-Value ratio. Once you have the appraisal in hand, take it to your mortgage holder (usually the bank or credit union) and have them make the necessary adjustments to your monthly mortgage payment. Money saved is money earned!!

Believe it or not, even after all of that the bank will send its own evaluators that may or may not agree with yours, leaving you to prove your findings. PMI is a financial hassle and a headache that you should avoid at all costs. Make certain that you have at least 20% of the value of the home to put down, and you can avoid it altogether. As a side note, certain types of FHA loans and VA loans are exempt from any PMI requirement. Reading the mortgage and understanding it is an absolute necessity. Make sure you know everything you are paying for before you sign it.

for the loan, they also have to take on all the costs of trying to re-sell the property. As a rule, banks have found that they can re-sell a home for 80% of its value. The 20%, then, is to cover their loss.

Location, Location, Location

An old saying in real estate is that these are the three most important things. How true this is, and you need to think about it very early in the process. Not only will this be the primary factor in the value of a property, it also can affect your security and standard of living. As a prospective buyer, you must be aware of the surroundings of the house you're interested in. Is the house across the street in poor repair or have washers being used as planters in the front yard? Does the neighborhood or house back up to a landfill? Is it on a road that leads to the high school football field and your road will become like I-95 every Friday night? Is it under the approach path for the airport that's three miles away?

Even if you don't care about these things yourself, it may not be so attractive to a potential buyer when it comes time to sell your home. Drive around the neighborhood to see what's there. If you are really interested, drive around on different days and at different times of the day to see what it's like. A neighborhood will be very different at eleven o'clock on a Tuesday morning versus three o'clock on a Saturday afternoon. If you still like it, you may wish to try talking to one or two of the neighbors. Ask them how they like the neighborhood. You can be sure that they will fill you in on every last detail of what is going on there. Neighbors like to talk and gossip.

When considering location, there are many things to remember. Most of these will be the same as you deal with in looking for rental property, but there are others as well. Is the property located in a flood zone? How big is the yard? Will you/can you maintain it or will you/can you hire a service to do it? Remember, in some localities, failure to maintain your property to community standards can result in significant fines and fees. And all repairs your property will require are your responsibility also.

There are a lot of variables that go into deciding whether or not a home is in a good location for you. We will not presume to tell you what they are as they are different for every person and family, but some characteristics may be: the amount of land, a specific number of bedrooms or bathrooms, age, style, school district, pool or no pool, and so forth. The combinations are nearly endless. Each variation will impact how much you pay and where you will look to purchase your home.

Location is such a huge part of real estate because not only does it affect the price you will pay for the home, but it has hidden costs that you might not think about. Will it affect your commute? Will it cost you more in gas, vehicle maintenance, or time? One suggestion is to pull out a map and mark several important locations in your life such as:

- Your job and/or your spouse's job
- Your place of worship
- Places you frequently shop—such as grocery store, gas, bank, post office, or anyplace that you frequent more than once a week or so.
- The school(s) your children attend. Don't forget to plan for future school attendance. Children do grow up.

Once you have done this, a pattern should emerge. Now, how far or how long of a commute do you want this to be? Time and distance is not the same thing. An hour's commute may carry you fifty miles or more if it's on the open road. On the other hand, it may take you an hour to go only two or three miles in heavy city traffic where there's a traffic light on every block. You may move close to your church, which you attend one or two days a week, but in doing so, you will move further away from your job, which you commute to five days a week. This decision will determine where you should look. While we're at it, let's think about one other thing that many people forget about: the sun. Think about it. If you live west of the places you mapped, there's a good chance you will be driving into the sun every morning and driving home every evening with the sun in your eyes. It is something to keep in mind.

Home inspection

When you go to purchase the home, either you, the bank, the seller, or a combination of the three will insist on involving some other parties. A home inspector is almost always part of that process. After all, the buyer, a smart one, will wish to know if there is anything that he may not see that will cost him money after the sale is

INSTRUCTOR TALKING POINT

Home inspectors are a vital part of the home buying process. They should be thorough AND licensed. The examples above are only some of the things they should be looking for. They will also look at the landscaping (are there trees overhanging the roof?), water pressure, eaves and downspouts, the electrical panel (are there enough amps to supply the entire house? are circuits doubled up?), the connections between rooms (are the rooms original or added on?), and the solidity of the floors themselves. The home inspector should be able to answer ALL your questions about the safety and solidity of the construction of your home.

complete. He should be looking for evidence of past or present termite problems, water damage from a leaky roof, an air conditioner/furnace that is about to go out, or a settling foundation. Any of these problems, or others, could conceivably cost the new owner thousands or even tens of thousands of dollars.

There's an old Tom Hanks movie called The Money Pit. In it, a couple finds a wonderful-looking mansion and purchases it. Then, they find out all the problems with it. Things like rotted floors, electrical problems and plumbing issues. The movie is a comedy, but if you are the actual owner of a money pit you won't be laughing.

The home inspector is licensed and bonded to perform a qualified inspection of the property. They are putting their reputation on the line that the house has or does not have certain problems. The level of home inspection can vary. Some are more thorough than others. Some inspections are cheap, some are not. You get what you pay for. Most won't cost too much and it would give you the peace of mind that there are not any lurking problems that will give you an unpleasant surprise. Be a smart home buyer and insist on a home inspection even if it is not required by your lender. Most lending institutions will insist on this.

INSTRUCTOR TALKING POINT

As a side note, appraisers also dabble in other types of property such as personal property, intellectual property and business appraisals. If you have taken the Small Business Concepts course and successfully build a business after your release, a business appraiser can tell you how much the company is worth.

A person that is usually required by the bank is a real estate appraiser (and, yes, this will cost you even more money). This can also protect the buyer as well. Basically, this is a person that is trained and qualified to give a professional estimate of the value of the home. A real estate appraiser will basically tell you if that home that's listed for $175,000 that you're interested in is only worth $90,000.

Below is some advice for finding a good home inspector:

- Don't let your real estate agent choose the inspector. Hire someone who works for you without any conflict of interest.
- Inspect the inspector before you hire. Ask to see a sample home inspection report. Comprehensive reports run 20 to 50 pages and include color photos showing defects or concerns. Also ask about the length of the inspection. A thorough inspection takes a minimum of three to four hours.
- Walk through with the inspector. You'll learn a lot about your house.
- You may have to pay more for a certified inspector, but in the long run it's worth it. Certified inspectors use

sophisticated measuring and detection equipment that can find potential defects that can't be easily seen. Spend $1,000 now rather than $10,000 in surprise repairs later.

House Characteristics

The details or characteristics of the individual house also affect the value of the property. What is one person likes, another may not—especially if you try to resell the house later. A good idea is to stay away from weird or unusual. If you buy an old stone house at the top of a mountain with no driveway and no access but a long stone stairway, it'll take some work to find a buyer who shares the same tastes. The stranger the property, the longer it will likely take to sell it.

The age of the house

Buying an old house may sound like fun, but be aware of hidden pitfalls. That "great deal" on a fixer-upper may end up costing you tens of thousands in repairs.

Size

Of course, size affects value. But, it's deeper than you think. It is a dilemma that every buyer experiences. As a general rule of thumb, the largest house in the neighborhood can be purchased for the best deal. At the same time, when selling a house, it is usually the smallest house that is sold for the best price. This can be a confusing concept, but it has to do with the selling prices of the other houses in the neighborhood.

Say the prices of houses in the area range from $150,000 to $200,000. They're all around 2,000 square feet. This means that they are selling for between $75.00 and $100.00 per square foot. Now, you find a home in that neighborhood that is 3,000 square feet. By the rates around the neighborhood, you should pay $225,000 to $300,000 for that house. However, the highest price in the neighborhood is $200,000, and you tell your realtor that that's as high as you're willing to go. If you're lucky, the owner agrees. Congratulations, you just bought that house for less than you should have. You only paid $66.67 per square foot.

It may sound a bit confusing, but it works. This is also important if you ever want to contest the appraised value of your home.

Floor Plan

A word of warning here, again, is to watch out for the weird. Weird is hard to sell. For example:

A man was looking at an older two-story wood frame house, advertised as a three bedroom, one bath. What he found inside was this…The staircase came upstairs, directly into a room. That was bedroom number one. On the far side of the room was a bathroom. On the other side of the bathroom was a doorway leading to

INSTRUCTOR TALKING POINT

A couple more examples...
Example #2—A family moved from Europe and built themselves a really nice house for about $350,000. But, it was a bit weird. All the windows were made out of sections of concrete culvert pipe. By the front door was a large stone turret, like you would see in a castle. And, on the inside, the room arrangement was just as strange. The large family room/living room was sunken. Around the perimeter of the room were all the other rooms—bedrooms, bathrooms, laundry, kitchen, everything. All the rooms had rounded archways, with no interior doors at all inside the house. For privacy, there were hanging curtains. When the house sold ten years later, the owner lost over $100,000 on his investment, even though the real estate market was still strong at that time.

Example #3—A man had a house built in southern Florida. It was a nice house on 5 acres. However, when the man had it built, he didn't install central air conditioning. Instead, he built the house with three-foot overhangs to provide more shade on the walls. It was outside of town, but the area it was in went up in value over the years. When it came time to sell, it was one of the hottest areas in the county, but, due to the lack of A/C, it took more than six months to sell the home, even though it was priced lower than the others in the neighborhood. No one wanted to buy a house and spend thousands of dollars installing air conditioning and duct work.

bedroom number two, and a doorway there led to bedroom number three. Whoever lived in bedroom number one would not only have the rest of the family tramping through their room to go up and downstairs, any guests needing to use the bathroom would have to do so as well.

Now, you may say that you don't have to use the first room as a bedroom, and you are right. But the weird room arrangement lost the owner money when it came time to sell. So, the word to the wise is to stay away from weird. If you like your house painted in orange and blue, or garnet and gold, because those are your favorite team's colors, that's okay. Just make sure you repaint the house a nice tan or off-white before you put it on the market.

Attorneys and Title Agencies can also be involved in the process of buying a home (along with their associated fees). The purchase of a home may very well be THE biggest and most important transaction any of us will make. There is a lot of money involved and a lot of preparation required. More than almost any other area of your financial life, you need to arm yourself with knowledge going into this entire process. Not having power or control here WILL cause you major financial difficulty later.

Finding Property to Buy:

Thinking about Location, like we did above, is only the beginning of the process. Once you know where you want to look for a property, now you need to know a few more things. For instance, even if you know WHERE you want to buy, what kind of home are you looking for? There are several options.

Trailer

This term is almost always used as a slang term, or derogatory term, and is used to describe any style of mobile home. The true definition is that a trailer is a portable living unit that is towed behind another vehicle such as a car or truck. A synonym for trailer is camper. These are designed for short-term living, but sometimes are set up as a permanent structure.

Modular Home

INSTRUCTOR TALKING POINT

I don't know if you remember, but way back in Chapter One we talked about Devon and his budget. Devon got a job working at Taco Bell as a first step toward his goal of starting a business building and selling modular homes. He needed $10,000 - $15,000 minimum in order to start his business. How long would that take him to save up? Scrounging for every penny, it would take him almost ten years to save up the money if he stayed at minimum wage with his Taco Bell job. That's possible, but not very encouraging. Remember that the job he took was his first offer. He took the job at Taco Bell to gain employment. He now has ten years to build his skills, broaden his education, gain promotions and raises or move on to a better career. If he moved up to the Machinist job we mentioned, he could save up the money he needed in less than three years.

INSTRUCTOR TALKING POINT

So, after five years, Devon now has enough capital saved up to start his business. What exactly does it mean to build and sell modular homes? Here is Devon's business idea:

The main cost of building a new house comes from materials and labor. In the area where Devon lives, houses cost about $100 per square foot to build. That means a 1,250 square foot house would cost him $125,000 (plus the cost of the land). If Devon got a conventional mortgage loan, he would need to put down $30,000 ($125,000 for the house + $25,000 for the land = $150,000 times 20% down = $30,000 down).

Devon doesn't want a conventional mortgage loan. His idea is to buy only the plot of land worth $25,000. In order to buy land, you need a little more down for the bank to approve the loan (40% instead of 20%). That means Devon needs $10,000 for a down payment and a $15,000 loan from the bank for the rest of the money. Instead of a conventional loan, Devon gets an "interest-only" loan. In this type of loan, every dollar he pays will go toward interest and none to principle. The reason Devon does this is that it will mean less money out of his pocket. This loan will require a monthly payment of around $125 per month.

Devon then holds onto the property for a year. He does nothing to it except to clean up and clear the lot, maybe grade it. Otherwise, it just sits there. Why does he do this? It's because of the restrictions imposed by the bank. Devon needs to hold onto the property for that year without building any structures on it. They will then consider the property to be "seasoned." What Devon does do during that year is contact a modular home builder to arrange and secure a set of building plans that meet with his specifications. After 12 months, Devon gets the plans approved by the county permit departments (plumbing, electrical, HVAC, roof, concrete). The land he bought is in an area with a Homeowners' Association, so he needs to get the plans for the house approved by them as well. He then goes to the same bank where he got his "interest-only" loan for the land and gets a new loan. This one is a "Construction-to-Permanent" loan to cover the cost of the house and the balance of the loan on the land. He can get this loan for a lot less than a loan for a "stick" or site-built home for a number of reasons:

- The bank is not going to give him direct access to the funds. They can control their liability by paying out the money directly to the building contractor on a schedule of payments. In other words, the bank doesn't have to hand over the money all at once.
- They are going to pay off his loan on the property of $15,000. The full amount is still owed because he secured an interest-only loan. But, with the signing of this new loan, he now owns the property in full and is using it as collateral on the loan for the construction. If anything happens and Devon is unable to pay back the construction-to-perm loan, the bank gets the property.
- Once the foundation and/or slab have been poured, the bank releases the funds to pay the concrete guy. After that, they pay for the amount that the modular home builder is charging to build the house.

Let's look at what the home is going to cost. If Devon went to a modular home builder, they can build his home no matter what the weather is outside because his home is being built inside a manufacturing facility in pieces. They can run the plant 24 hours a day so the labor cost is less than a site-built home because there are no delays due to weather. The materials cost less because everything can be laser-measured and cut causing less waste. Waste and building delays make up a huge portion of the cost of building a traditional home.

Because of these savings, Devon's home costs him around $60 per square foot to build, deliver and set-up. Once the home is built and inspected, the bank releases some of the funds to the modular home builder. How long is it going to take to build this modular home? Probably about 2 weeks. Compare this to 6 to 12 months to build a house on-site. Once the trucking company, if it is not owned by the modular home company, delivers the home the bank will release the funds to pay them.

How much did Devon have to borrow from the bank in order to have the modular home built? $100,000. That's $15,000 to pay off the property loan. The modular home he chose was a 1,250 square foot home. At $60 per square foot, that's $75,000. He spent another $10,000 on landscaping, finishing, and so forth. $15,000 + $75,000 + $10,000 = $100,000.

Now let's look at the loan itself. Devon would have needed $30,000 on a $150,000 home (that's 20%). The loan he actually gets will be a little bit different. For one, he doesn't need to put any money down. The home he's having built will be valued at $150,000 (which fits the value of other houses in the neighborhood), and he needs to borrow $100,000. As far as the bank is concerned, since the land has been seasoned and the home and land will be the security for the mortgage, Devon has put down the difference between the value of the home ($150,000) and the value of the loan itself ($100,000). In the bank's eyes, he put 33% down.
What does Devon do with the home once it is built? Anything he wants. He just got a $150,000 home for $10,000 down. He can live in it, rent it out, or sell it. Devon's plan is to sell it. Here's what he figures:

INSTRUCTOR TALKING POINT

The Market value of the home he had built is $150,000. He sells the home for 90% of the market value (or $135,000). There are fees owed to the Real Estate Agent plus some other miscellaneous fees of $10,000. At closing, he receives $125,000. He needs to pay back the bank for his loan of $100,000, so he gains $25,000. He's already out the original $10,000 that he put down on the property, of course. Devon walks away with a $15,000 profit.

$135,000 - $10,000 = $125,000 - $100,000 = $25,000 - $10,000 = $15,000

What does he do with that $15,000? He turns it around and does it again with another $10,000 and invests the other $5,000. Once he sells another house, he has $20,000 (or more). That translates into two more houses and a profit of $30,000. That gives him enough to build and sell three more houses at a profit of $45,000. Before long, he has a constant cash flow coming and a series of houses on the market. And, what if he manages to sell some of those homes for closer to or more than market value? In the example above, he would have doubled his profits if he managed to sell the home for the full $150,000. That's not always realistic, but it's a possible goal. Of course, his plan will only work for so long in any given market. Once he reaches a saturation point, he plans to move on to a new area. Potentially, Devon could end up with a real estate empire. Is that a dream? Yes, but with careful financial planning and budgeting it isn't a completely impossible dream. It might take him years to get there and a few more years to build up a good income, but it's a goal that he could reach.

For those who think this is all pie-in-the-sky stuff, believe it or not this plan has actually been carried out. A doctor in Destin, Florida bought four plots of land in a subdivision. She built three modular homes on three of the plots and sold them. Those homes had a market value of $250,000. With the profits from those, she was able to pay for her own home on the fourth plot without it costing her a dime. It's real, and it works. If Devon is willing to make some real sacrifices and apply some serious discipline, he can get there.

This is a living unit that is built in sections and then transported to its permanent location. Once there, the sections are bolted together and a roof is built over the entire structure. It is built to "regular" house building codes. It has wooden floor trusses.

Manufactured Home

This is a living unit that is built to "regular" house building standards, but the foundation of it consists of one or more steel I-beams. Plywood is then laid over the beams and the manufactured home is built on it. The structure can be built in one or more sections, although usually when it is in sections, it is usually done in two halves. Once on site, the sections are bolted together.

Mobile Home

This is a house that is built to mobile home standards and is built on a steel I-beam foundation. It may or may not be in more than one section. As an example, it may have interior walls made of 2x3 studs instead of the typical 2x4's found in a regular house and may have 3/8" wallpapered drywall, rather than the more typical ½" or 5/8" drywall found in a site built home.

House

This is sometimes called a stick-built or site-built home. This type of home is constructed from scratch on the building site. The foundation is poured, the walls built, the roof added and the interior finished —all on the site by a licensed contractor. The quality may vary widely from hovels to palaces, but the key is they are built on site.

There are also Condos, duplexes, and town-homes. These operate a little differently from freestanding homes. You also have the option to buy or rent land and build on it. These all come with their own advantages and disadvantages, but we'll be concentrating specifically on "regular" homes for simplicity's sake.

Zoning and Deed Restrictions

These are also important. Say you want to open a small-engine repair shop. Nothing fancy, just a shade-tree operation where you do some work to earn a few extra bucks. Do you want to spend $250,000 on a house only to find out you are not allowed to open your shop in the detached garage on the property? If you don't do your homework that is exactly what could happen. The county or city zoning office will tell you what is and is not allowed for the property you're looking at buying.

But, that's not the only thing to consider. You also need to find out about any deed restrictions or homeowner's association restrictions. If you purchase out in the country, this probably won't be a problem. However, in a more populated neighborhood, you had better check. Something like your small engine repair shop may be allowed by the zoning codes, but not allowed by the deed restrictions.

The county zoning office, city zoning office, the real estate agent, or even a neighbor can tell you if there are any restrictions. If there are, locate a copy of them and study them. Often, you can get a copy of them from the county building department, county zoning office or the county clerk's office. A general rule of thumb is the higher the dollar value of the neighborhood, the more deed restrictions there are. Some examples of deed restrictions may be:

- All mailboxes and trash cans be the same style or color
- No vehicles parked on the street
- No commercial vehicles or boats parked in the driveway
- If you re-paint the house, it must be certain colors
- No laundry hanging out to dry on clotheslines

The list of possibilities is nearly endless. Be a smart buyer and be aware of them before agreeing to buy the property.

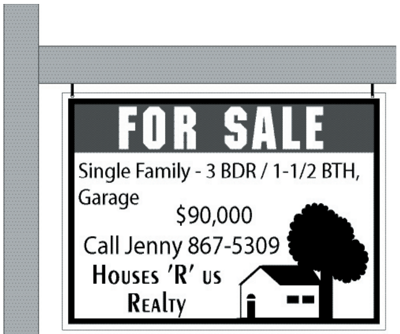
Once you've made a decision on what type of home to buy, you'll need to find someone to help you find it. The same sources you use to find a rental property will help you find property for sale. But remember, while renting begins a mutual relationship with the landlord, buying leaves you solely responsible, just like buying a car. Most people use a real estate agent or broker. Both are professionals who are trained in facilitating the buying and selling of real estate. Some specialize in particular types of property such as commercial, rental properties, vacant properties, or single-family residences.

You do not necessarily need to have a real estate professional assist you in the purchase or sale of a home, particularly in the age of the internet. However, there are specific laws, both state and federal, that deal with the buying and selling of real estate. A realtor is trained to keep up with these laws as they change. And, they change often.

It would be nice if these realtors worked for free, but they do not. They are professionals who work for a commission. It is a percentage of the sale (or purchase) price of the property (usually about seven percent in the state of Florida).

The decision on whether or not to use the services of a realtor is purely an individual one. Remember, though, they are professionals and you may lose money if you choose not to use their services. Realtors do subscribe to a Code of Ethics as outlined by the National Association of Realtors. This Code of Ethics dictates what a realtor is professionally allowed and not allowed to do. Failure to abide by them may result in their licensing being revoked. But, you should still be careful of those who may profit from the transaction, as they might not have your best interests at heart. Some unscrupulous realtors might push you into buying more than you can afford. The homeowner himself might also misrepresent the property to get out from under an economic burden – and transfer the problem to you.

So, I've decided on what I need and found a home that meets my needs and my financial situation. Now, what?



What to look for in a mortgage agreement:

A mortgage is a binding legal document for a very significant amount of money. It wouldn't be a bad idea to consult legal counsel if you are unfamiliar with the process and documents. This is part of where those attorney's fees might come in. Never sign anything you have not read and understood completely. Ask for explanations of any and every portion that is not clear to you.

Be aware that the miracle of compound interest that helps to build your savings account will also build your debt. Often, the interest paid on a long-term loan, such as a mortgage, will exceed the original cost of the entire loan. Your interest rate, the length of the loan, payments over the minimum required, will all dictate your final costs. Generally, the longer the term of the loan, the lower the payments and the greater overall interest charged.

If you hadn't noticed, the mortgage market tends to use a language all its own. One of the most important for a home buyer to understand is: amortization. Amortization is a big word, but it actually has a very simple definition for our purposes. Amortization means how fast you are going to pay the loan back. Thirty-year amortization means you will gradually return the money you borrowed over a thirty-year time period. You can set any time interval you want (5 years, 10 years, 17 years, 52 years…). As long as the bank agrees, that will be the length of time you have to pay back your mortgage. The two most common mortgage lengths are 15 and 30 years.

Your mortgage payment has two parts, interest and principal. The principal is the amount you actually owe on the money you borrowed. If you borrowed $100,000, you owe $100,000 in principal. The interest is the money you pay to the lender for providing you with the loan. It's the bank's profit, essentially, and it's calculated as a percentage of the principal you still owe. Each time you make a mortgage payment the lender receives interest, and part of the loan's principal amount back.

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But, you might be shocked to learn how little of your monthly mortgage payment goes to reducing your loan and how much goes to paying interest. The schedule at right is an example of a $100,000 mortgage loan, amortized over thirty years, at a rate of 7%. The monthly payment is $665.30 and that payment is made 360 times over the course of the loan. The first payment of $665.30 reduces the $100,000 loan by only $81.97! The rest of the money, $583.33, goes to interest. It isn't until the 242nd payment (more than 20 years) that more of your monthly payment goes to principal reduction than interest. Even on the very final payment $3.86 goes to interest. Over the course of the loan, you paid $139,508.90 in interest. Yes, that means that you repaid $239,508.90 on your $100,000 loan – more than double.

Amortization Schedule

Month	Interest Payment	Principal Reduction	Remaining Loan Balance
0			$100,000.00
1	$583.33	$81.97	$99,918.03
12	$577.92	$87.38	$98,984.19
24	$571.60	$93.70	$97,894.95
36	$564.83	$100.48	$96,726.96
48	$557.56	$107.74	$95,474.55
60	$549.77	$115.53	$94,131.59
120	$501.53	$163.77	$85,812.38
180	$433.13	$232.17	$74,018.87
240	$336.17	$329.13	$57,300.08
300	$198.72	$466.59	$33,599.10
360	$3.86	$657.59	0

What can we do about that? Always keep in mind that your goals are not the same as the bank's goals. Your goal is to keep as much of your own money as you can. Their goal is to take as much of your money as they can. It might seem to make sense that a bank would want to give you the shortest term on a loan as possible. After all, that means they get paid back quicker, right? Actually, the reverse is true. The less time you take to pay back your loan, the less money they end up making. Let's look at a couple of comparisons.

Here's a $95,000 mortgage loan at 7% interest:

Payment using fifteen-year amortization: $853.89 per month
Payment using thirty-year amortization: $632.04 per month

The difference is $221.85 per month if you choose the thirty-year loan versus the fifteen-year loan. In our example you originally borrowed $95,000; but, if you take a closer look at your total loan cost after ten years:

The thirty-year loan has a balance left to pay, the amount you still owe, of $81,521.76.
The fifteen-year loan has a balance left to pay, the amount you still owe, of $43,122.99.

On the thirty-year loan you made ten years of payments for a total of $75,844.80 but the balance due on your loan was only reduced by $13,478.24 ($95,000 - $81,521.76 = $13,478.24). That means $62,366.56 of your $75,844.80 went to interest.

Now compare:

On the fifteen-year loan you made ten years of payments for a total of $102,466.80 but your balance due on the loan was reduced by $51,877.01 ($95,000 - $43,122.99 = $51,877.01).

You paid $26,622.00 more in payments with the fifteen-year loan, but you reduced principal by $38,398.77 more than if you had used the thirty-year loan ($51,877.01 - $13,478.24 = $38,398.77). A $38,398.77 balance reduction minus the $26,622.00 more in payments means an overall savings of $11,776.77. It seems crazy that you could pay a higher payment using a fifteen-year loan and as a result save $11,776.77 in ten years, but that's the difference in interest expense. That's on a $95,000 home! On the average home costing $175,000, your savings would be $21,694.19.

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Here's another example on a $90,000 mortgage loan at 6.5%. The total interest paid on the loan, if you pay it off in fifteen years, is $51,119.39. The total interest paid on the loan if you pay it off in thirty years is $114,790.04. Understanding amortization is extremely important to your finances. Look at it this way: Would you rather pay $141,119.39 or $204,790.04 to buy the same $90,000 house? In this example, choosing a fifteen-year amortization schedule saved you almost sixty-four thousand dollars. Always use a fifteen-year amortization schedule when buying a home. By the way, if you pay off the mortgage in fifteen years, what should you do with the extra $784.00 that you had going to the mortgage each month? PIZZA PARTY?

Here's a better idea: if you invest the $784.00 each month into a good growth mutual fund that averages 8% growth each year, at the end of fifteen years you would have an account worth $270,037.55. Oh, and a home that's fully paid for!

Fifteen vs. Thirty-Year Fixed Loan

	15-Year	30-Year
Monthly Payment	$ 784.00	$ 568.86
Total Cost of Home (Loan term x monthly payments)	$141,119.39	$204,790.04
Minus Original Loan Amount	$ 90,000	$ 90,000
Total Interest Paid for Loan	$ 51,119.39	$114,790.04

Money Saver! The lesson to learn here is that the longer you borrow money, the more interest you pay. You want the shortest amortization schedule possible when you borrow. When buying a home, most people only consider how much the mortgage payment will be. It's far wiser to first consider how much the total cost of the home will be.

INSTRUCTOR TALKING POINT

For those getting out soon, Bankrate.com has some excellent, easy to use calculators for amortization. But, how exactly does the bank figure out all those monthly payments? They use a simple formula:

(loan balance) x (interest rate) / 12 = your monthly interest

And, that gets recalculated every month. For those who are very perceptive, there is a way to use this to your advantage. Because the interest get recalculated every month, you can lower your interest payments by making extra payments toward the principal loan amount.

What does that mean, and how does it work to our advantage? Let's say you take out a 30-year loan as in the example above. Your monthly payments are $569.86 (which might be more manageable with your budget). Make sure that you tell the bank that your extra payments are to go toward the principal on the loan. What if we paid an extra $131.37 every month? Instead of $569.86, we pay $701.23. That's still less than the 15 year loan payments. It's adds about $30 per week. It might be tighter, but it could be manageable if it works for our budget. What would it mean? Over the course of the loan, it would mean paying $50,358.87 **less** in interest and paying the loan off 12 years early.

Is it worth it to pay an extra $28,375.92 above your normal payment over 18 years in order to save $50,358.87? The answer should be obvious.

In addition to amortization, you need to be aware that there are many types of mortgages and lenders are constantly experimenting with new ones. Be cautious of such arrangements as adjustable rate mortgages (**ARM**) because while you hope your income will increase over time, you have no guarantees, while it is guaranteed that your payments will increase.

Please use the power of the internet when making these complex and important decisions, but please also remember to be an informed consumer of web sites. Commercial sites may be more concerned with making a sale than with your economic well-being. Wiki sites and blogs are at the mercy of the posters, and malicious content may appear to deceive the unwary. Some sites are just so poorly made and maintained that they are filled with errors. In the volatile real estate market, sites may not be updated often enough to reflect the current situation.

Different Mortgage Types

Mortgages are different based on the amount of interest that you pay on the loan, as well as the schedule involved for payment.

The most common forms of mortgages are:

Fixed Rate Mortgages:

In a fixed rate mortgage plan, interest rates are and monthly payments are predetermined prior to loan acceptance. These amounts will not change for the entire period of payment agreed to. This is known as the more "traditional" form of mortgage plan. If you get a fixed rate mortgage for 30 years at 7%, you will pay 7% interest for 30 years.

Adjustable Rate Mortgage:

Adjustable rate mortgages begin with the same interest rate and monthly payments for the home loan for a set period of time: anywhere from six months to five years. After the specified period of time, interest rates and monthly payments may be adjusted periodically in order to reflect market rates. In other words, this type of mortgage starts out like a fixed mortgage, and then the lender may "adjust" the rates later on. If you had the same 30-year mortgage with a 6.5% (5/2) ARM means that you would pay 6.5% interest for the first 5 years. After that, the lender could raise the interest rate anything up to 2% (5 years/2% maximum raise). They can raise (or lower) the interest rate up to 2% every year to reflect the market average (as set by Fannie Mae and Freddie Mac) up to a maximum of 15%. That means that for a $90,000 loan, you could be paying $568.86 per month to start. After five years, the interest rate goes up and you end up with monthly payments of $678.40 (and suddenly paying $139.81 in extra interest in just the first month). A year later, the interest rate could jump again. If it ended up another 1% higher, your monthly payments would suddenly be $734.74 (paying an extra $68.73 in interest again). ARM's can be very useful, if you know you're staying there for a short term. If you overstay that term, it can get very expensive, very fast.

Balloon Mortgage:

This type of mortgage also begins like a fixed mortgage, with interest rates and payments being fixed for a specified time period. After the specified amount of time, the borrower must pay the loan back in its entirety. This can be a good option to get you a lower interest rate IF you have the ability to pay back a large sum of money all at once. If you get a $90,000 balloon mortgage at a 6% interest rate with a 5 year term, your initial monthly payments will be much lower than a traditional mortgage. You will only owe $539.60 per month. Until month 61. At that point, the balloon "bursts," and you now owe the full amount remaining (which in this case is $83,748.92) in one lump sum. You will pay much less interest with a balloon mortgage (only $26,124.92), but you also need to come up with almost eighty-four thousand dollars all at once.

Interest-Only Mortgage:

In this type of mortgage, for a short period of time the borrower is initially allowed to pay for only the interest portion on the loan. This has the effect of lowering monthly payment amounts in the beginning of the loan period. After the specified amount of time, payments will begin to include both the principal and the interest, usually in higher amounts than traditional fixed rate payments.

A common theme among the various mortgage types is that many of them begin like a traditional fixed rate plan, and then later on implement differences in interest rates and monthly payments. This helps provide some financial stability in the beginning stages of home ownership.

Advantages and Disadvantages of the Different Mortgage Types:

There are several pros and cons associated with each type of mortgage. Explore the different types to learn which type might best suit your needs:

Fixed Rate:

- Provides borrower more stability
- The borrower will know exactly how much is owed each month and can plan their finances around the monthly rates
- However, both interest rates and the monthly payments are typically higher than other forms of mortgages.

Adjustable Rate:

- Usually the initial interest rates and monthly payments are lower than traditional fixed rate mortgage amounts.
- The lender will often promise not to raise rates above a certain amount (cap), even if the market value is higher.
- Often more suitable for buyers who are likely to move out of their house after a short period of time – if you plan to move within the time period covered by the lower interest rate, this could be a desirable mortgage type
- However, the borrower assumes the risk of increasing interest rates and monthly payments, especially in a fluctuating economy

Balloon-type:

- The homeowner can usually pay off the mortgage in a shorter period of time than in a traditional or adjustable rate plan
- An average time of complete repayment is typically five years
- However, most people are not able to repay the entire loan after such a short period of time
- May create a situation where another loan is needed in order to pay off the previous loan

Interest Only:

- Currently popular among new home buyers
- The initial payments will be much, much lower than in fixed rate plans
- This allows borrowers to save money for other investment options
- The reduced payments may help borrowers obtain a larger mortgage than other plans
- Also suitable for those who are likely to move after a short time period
- However, the homeowner must be prepared for the large increase in payments that becomes due after the initial interest-only period

INSTRUCTOR TALKING POINT

There are other options for mortgages than what we discussed here. Several Alternative Mortgage Instruments (or AMI's) have been developed in the last few years dealing with residential, single-family housing. Some types of these are:

Variable Rate Mortgages (VRM)

These are the most well-known AMI's and, although there are various forms for interest rate adjustment, in each type the rate of interest is tied to a reference rate and fluctuates accordingly. It works similarly to an Adjustable Rate Mortgage, but a variation of the Variable Rate Mortgage allows the maturity of the loan to vary in response to changing interest rate levels. In other words, if the interest rate goes beyond a certain level, it turns into a balloon mortgage and, suddenly, the balance of the loan comes due. VRM's can get very confusing.

Graduated Payment Mortgage (GPM)

This plan requires small payments at the beginning of the loan that get larger and larger as the loan is repaid. The rate at which the payments rise is specified in the loan contract. Since the payments at the start are lower than under a fixed rate loan, a certain degree of "negative amortizing" takes place. That means that the outstanding balance for the first few years will be greater than the starting balance of the loan. This type of loan can be popular with young first-time home buyers who don't have as much income to make payments at the start of the loan.

INSTRUCTOR TALKING POINT

Reverse Annuity Mortgage (RAM)

This really is not a mortgage. With a RAM, the bank pays you money based on the equity you have in your house. They pay it out either as a lump sum or in installments and allow you to hold the home in a "life estate." What that means, in simple terms, is that you get to remain in the home (but have to maintain it according to the bank's standards) until you pass away, at which point the bank takes possession of it. This plan is designed for senior citizens without much income but with sizable equity in their homes to supplement their income. Think very carefully before participating in a Reverse Mortgage. Signing one of these loans is basically selling the equity in your home (equity that you might have spent 15 to 30 years building up). You are signing your home away to the bank but still maintain the responsibility for insuring and maintaining it.

Deferred Interest Mortgage (DIM)

This less well-known program is one in which the borrower receives a lower interest rate in exchange for an agreement to pay the deferred interest when the property is sold. In other words, if you have get a loan at 7%, but make it a DIM, you might pay only 3.5% interest in your monthly payments. However, when you sell the property, you then become responsible for all the extra interest still unpaid. This loan is usually only attractive to investors interested in short-term turnarounds for their properties as it is very vulnerable to changes in property value.

INSTRUCTOR TALKING POINT

One point that we keep stressing throughout this course is how vital it is to READ any contract you sign. In fact, any time you sign anything at all, read it. Even if it doesn't look like a contract (remember the signature card at the bank?) it might be one. Mortgages may be the largest loans you will ever take out, so it is even more important to understand everything you read. If you don't, get someone to help you.

The bank is required to provide you with a closing statement (called a HUD-1) at least 24 hours prior to signing. That means that they will generally give it to you exactly 24 hours before closing. The HUD-1 can include a lot of hidden charges that you might not be aware of. For example, a section of the form might look something like this: You must understand all of those charges and the fine print before signing it, though. How can you do that in 24 hours?

L. Settlement Charges		**Paid from Borrower's Funds at Settlement**	**Paid from Seller's Funds at Settlement**
800. Items Payable in Connection with Loan:			
801. Our Origination charge $\boxed{\$2{,}500.00}$	(from GFE #1) $ 3,221.34		
802. Your credit or charge (points) for the specific interest rate chosen	(from GFE #2) $ 0.00		
803. Your adjusted origination charges	(from GFE #A)	3,221.34	

See that $2,500 in the box on line 801? It won't show up anywhere on the amount on the left, but it still gets tacked on to the amount you have to pay. That's the closing agent's profit. You can request that that amount be reduced as it is completely unconnected with the loan. Be aware of what you are signing. It is the best way to limit your cost.

Should They Buy Or Rent?

Directions: For each of the following situations, circle RENT, BUY, or DEPENDS to indicate your opinion related to this person's housing decision. Also, give reasons for your response.

1. You are single, just out of school, and have moved to a new city to pursue a job opportunity.

Rent **Buy** **Depends**

Reason(s): ______________________________

2. You are married, with two children, and have another on the way. You have a good, stable job with a growing company.

Rent **Buy** **Depends**

Reason(s): ______________________________

3. You are married with no children. You have just lost your job and there does not seem to be another opportunity locally. You have some savings and are currently living in rented property.

Rent **Buy** **Depends**

Reason(s): ______________________________

4. Your friends are interest in a living arrangement with everyone sharing expenses. You have some savings, an inheritance, and a decent job.

Rent **Buy** **Depends**

Reason(s): ______________________________

5. You are married; your children are grown and moved out. You are nearing retirement and are living in the house in which you raised your family. With retirement, you expect your income to decrease. You have savings and are considering places that offer activities you enjoy.

Rent **Buy** **Depends**

Reason(s): ______________________________

6. You are single and engaged. You are both about to graduate and both have several job offers you are considering, both where you now live and in other cities.

Rent **Buy** **Depends**

Reason(s): ______________________________

Whichever way you choose to put a roof over your head, never underestimate the commitment you are making. A place to live can be a home, and it should be an important decision. Use the knowledge you have to make it wisely.

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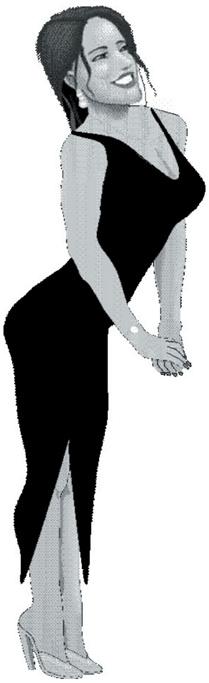
Advantages and Disadvantages of Renting vs. Buying

Renting — Advantages	Buying — Disadvantages
Lower Down Payment	**Expensive to Start**
This is not to say that there aren't significant initial costs involved in starting to rent. Generally, the renter will be responsible for the first month, last month, and security deposit. There can be additional fees (such as a pet deposit). If you are renting at $800/mon. The move-in fees would be $800+$800+$800 = $2,400	Most lending institutions will require a minimum of ten to twenty percent of the purchase price down. Much will depend on your credit score as to how favorable the terms will be. This means that for a home worth $100,000, you will need around $20,000 cash in the bank or equity in another piece of property plus points and closing costs of approximately 5%.
Flexibility of Movement	**Less Flexibility**
Even with a lease, your flexibility in being able to relocate is much easier if you rent. In Florida, there are two types of leases, short and long-term. Generally, a short-term lease is one of seven months' duration or less, a long-term lease is one of eight months or more (though most are in one year increments). There are fees for breaking a lease early (sometimes significant fees), but the option is there.	Purchasing a home more or less ties you down to that location. Wherever you move, if you put your house on the market, it may be there for a year or more before you're able to sell it. During this time, you still have to pay the mortgage, utilities and other associated bills in addition to the costs of a new place to live. It can get very expensive fast.
Maintenance and Repairs	**Maintenance and Repairs**
Since the property is not yours, you don't have to worry about this. You don't have to fix the roof, the hole in the wall (unless you caused it), or mow the lawn. That's the landlord's responsibility. Sounds great, and it can be. On the other hand, depending on the situation, you may have to put up with the problem until the landlord gets around to fixing it. (Note: Some rental agreements for houses and mobile homes include a clause requiring you to keep the yard mowed.)	Since the property is yours, all of the responsibility (and cost) of maintenance and repair falls on you, the same with any repairs. You may be able to delay some of these for a while. But, if a lightning strike takes out your A/C unit in August or a tree branch knocks a hole in your roof, it will come out of your pocket. An insurance policy will cover most major expenses, but not all. Meaning you also have the added cost of a homeowner's insurance policy.
Access to Amenities	**Amenities are not included**
If you rent in a larger apartment community, you may have access to laundry facilities, a gym, a swimming pool, tennis court, or other amenities. It's true that the costs of these things (if available) - as well as property taxes - are usually built into the rental price, but you don't have to worry about paying them individually and they are generally available at a small addition to the rent.	If you purchase a house, extras like gyms, tennis court access, and so on would all cost you additional money.

Renting — Disadvantages	Buying — Advantages
It is not yours	**It's yours**
You must receive written permission to do anything to the apartment. If your lease says "no pets" that means you either don't keep your dog or find another apartment. The landlord is the one that sets the rules, you are just living there. Violations of the lease agreement may void the lease contract (which can lead to eviction). Other restrictions may include "no children", "no smoking", or others.	Want to paint your house in lavender stripes? It's your property; you're free to do with it as you wish, right? Actually, wrong. There may be zoning restrictions and/or homeowner's association restrictions. However, basically, as long as whatever you do falls within the zoning and/or homeowner rules, and does not negatively impact your neighbor's enjoyment of his property, you can do it. As long as your lavender stripes don't cause your neighbor to enjoy his property less, go for it.
Nothing to show for your money	**You have something to show for it**
All the time you are paying the rent, you are actually building wealth for your landlord. By paying your rent payment every month, you're paying your landlord's mortgage for him. You have zero equity in the property. At $800 per month that's $9,600 per year you are giving away.	Over time, you build up equity in your home. Equity is the difference between the value of your home and the amount that you owe on it. For instance, if you owe $60,000 on the house, but it is worth $90,000, you have $30,000 equity in the house. In theory, if you sell the house, you'll have $30,000 left after the loan is paid off (minus realtor fees, closing costs, and other costs), of course.
Roommates	**Roommates**
This could be an advantage or a disadvantage. As we talked about before, after living in prison many of us probably look forward to not having any more roommates, but having one or two can cut our monthly expenses dramatically. An advantage to having a roommate in an apartment is that, unlike in prison, you get to pick who it is. **Note**: if you are on probation when you get out, be cautious of who you allow to be your roommate. It may be someone that your probation officer may have a problem with, or they may have habits that will distract you from starting your new life.	The same with renting; this is going to be based upon your own personal preferences and financial situation. It could be either an advantage or a disadvantage.

REEFS

Chapter 6 - Insurance



So, when you go to that party on Friday and that hot new girl from work, Bunny, starts talking to you, flirting, touching your arm while playing with her hair, and telling jokes heavy with innuendo, if you start talking about insurance policies it's a sure way to kill the conversation (along with any chance of taking a walk with Bunny out to the gazebo by the lake). Let's face it; insurance is not fun. It's not exciting. Even thinking about premium rates, coverage variables and actuarial tables is enough to put most people to sleep.

The unfortunate reality of life, however, is that even if you budget well, live within your means, and manage your money, no matter how hard you've worked all of it can be wiped out by an accident or an illness. Life often seems to operate based on Murphy's Law ("Whatever can go wrong, will go wrong"), and we can assume that, sooner or later, we will face some kind of untimely, negative surprise. There will be 20 inches of rain. The street will flood. Your car will end up floating away in the torrent. You will get a bacterial infection from wading through the water to escape. While you are staying at the emergency shelter, someone will break into your apartment and loot it. Maybe none of these things will happen. Maybe all of them will. One thing is certain: At some point, something will go wrong. The best way for you to protect yourself from these unpleasant surprises is to be insured. To do this, you need to understand what insurance is and how it works. It might be an unfortunate fact, but it is something that we all need to think about.

INSTRUCTOR TALKING POINT

It's important to understand this fact: You need insurance. It may be one of the most aggravating products to buy, as, for the most part, we all purchase insurance with the hope of never actually having to use it. Face it, if we have to use our car insurance, something has gone wrong. If we have to use our health insurance, we're generally sick. And, if we have to use our Life insurance, we're probably dead. Insurance is a long-term purchase, but it is vitally important to having sound financial health. Imagine any of those things going wrong for us (a car accident, an illness, or death) without having insurance. For most of us, that would mean being in severe debt for the rest of our lives (or leaving our loved ones behind with nothing to live on or protect them). Even in cases when it is not required by law, you **need** insurance.

One vital point to keep in mind no matter what kind of insurance you're looking for is that you need to know what your needs are. There is absolutely no point in underinsuring yourself, but over insuring yourself can be just as much of a pitfall. Your goal with any type of insurance is to get only as much protection as you need at the lowest cost. There are a number of ways to do this. One of the best is to work with a reputable insurance agent. Some agents work for only one company. A State Farm agent sells State Farm insurance policies; an Allstate agent sells Allstate insurance policies, and so forth. There's a second type of insurance agent, and that's one who sells insurance for several different companies. Which type of agent you use is up to you, but the best way to buy insurance is to first clearly understand your insurance needs and then shop around and make sure the agents you speak to clearly understand all your needs as well.

Your agent should also take the time to make sure that you're fully aware of all the different features of each policy and how each one will benefit you in different scenarios. If the agent doesn't take the time to do this, or seems too busy, you have the wrong agent. In short, find an agent that cares. You want an agent that will work with you to make sure all your needs are met.

Always buy insurance from a solid company, ideally one with an A or A+ rating. After all, you want the company to be around if you have a claim. Finally, make sure to include your insurance payments in your budget.

INSTRUCTOR TALKING POINT

Are there disreputable insurance agents? Of course. If there is a way to cheat people out of their money, you can guarantee that someone has found a way to capitalize on that. In the case of insurance agents, there are a number of ways that you can be cheated. One of the biggest ways is to sell you insurance that you do not need. Overinsurance is a real financial danger. Firms will push everything on you from “cancer coverage” to “tuition protection.” In an age of hurricanes, tsunamis, stock market crashes and banking crises, it isn’t any wonder that people feel insecure. Companies are more than happy to try to put people more at ease. If someone thinks they need it, they’ll be right there to sell it to them. So, they respond by rolling out a raft of newfangled insurance policies designed to protect against real – and perceived – risks.

Many financial planners recommend focusing on getting the most value from traditional insurance policies and skipping the rest. Health insurance and auto insurance are the big areas to focus on getting the best possible coverage that you can afford. Jennifer Lopez famously took out a $2 million insurance policy on her butt. The rest of us can realistically forgo that. What about pet insurance? Should we take out a life insurance policy on the dog?

Loading up on policies makes sense as a psychological phenomemon, but it makes no financial sense. After all, the more money you spend on protection, the less money you will have left to protect. “If you can afford to replace it, don’t insure it,” says J. Robert Hunter, director of insurance for the Washington-based Consumer Federation of America and a former Texas insurance commissioner. Unfortunately, that includes the dog. We may not be able to “replace” it, but we also seldom suffer serious financial difficulty as a result of its death.

Ask yourself what your insurance **needs** are, and then work from there.

Money Saver! Carefully figure out your insurance needs. Then shop around to get the best policy you can find for your money.

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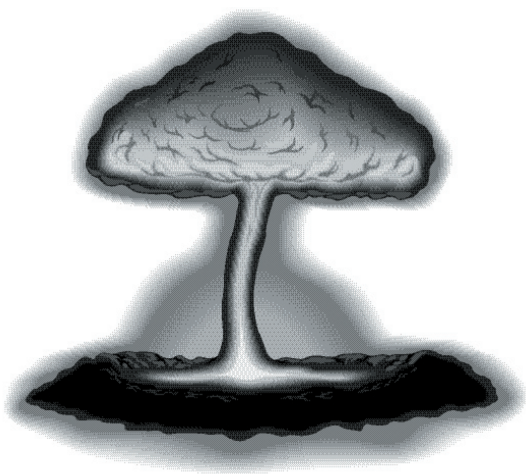
Realize this important point: All insurance, no matter what type, is based on risk. Insurance companies make money by basically betting on the likelihood of you needing to use their services. The insurance company’s goal is to get as much money from you as they can for as little reimbursement as possible. They employ entire departments that do nothing but look at different factors that might affect your “risk level” and determine your costs based on that risk level. Are you a stamp-collecting secretary for an accountant in Idaho? You will probably pay less for life insurance than a stunt pilot. Are you a 65-year-old smoker living in Chicago? Your health insurance will likely cost more than a 21-year-old non-smoker living in Burlington, Vermont. Different insurance types look at different factors, but if you are aware of your risk level you can make more informed decisions.

Your insurance goal is very different. Your goal is to provide for as much reimbursement as you can get (should it be needed) at the lowest possible cost.

The Five Different Types of Insurance

In this chapter we're going to review five different types of insurance: health, renters', homeowner's, life, and auto. Like any industry, insurance has its own "jargon," its own language of terms that are unique to insurance and what it does. Some terms to look out for:

- **Agent** – An individual who sells and services insurance policies
- **Claim** – A demand made by the insured person (or the beneficiary) for payment of the benefits provided by the policy
- **Coverage** – The extent of protection provided by an insurance policy
- **Rider** – An addition to your coverage that is written into the contract
- **Policy** – The written contract effecting insurance, or the certificate of insurance, including all clauses, riders, endorsements, and papers
- **Policyholder** – A person to whom an insurance policy is issued
- **Premium** – The price of insurance for a specific period of time



Health Insurance

Of all the types of insurance that you may need, health insurance may be the most important. No matter how healthy you are today, at some point everyone will need to use the health care system – whether for routine care, to treat an illness, or after an accident. Without health insurance, even a minor problem can throw a grenade right into the middle of your financial plans. Major problems can be more like a nuclear bomb dropped onto your finances. Put another way, the cost of your physical health can have a severe impact on your financial health.

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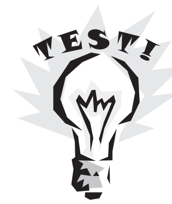
Health insurance allows you to get medical care when you need it by providing coverage for services to keep you healthy, such as annual physicals, screenings and immunizations. Health insurance also protects you from high treatment costs related to treatment for an illness or accident.

When you shop for health insurance, you have to make decisions about what to buy based on your financial situation and health care needs. As with any type of insurance, ask yourself: 1) How much insurance do I need? 2) How much will it cost? It's also important when shopping for health insurance to understand the different components that make up a health insurance policy.

Cost components:



- **Deductibles –** A deductible is the amount you will pay out of your pocket annually, in addition to your monthly premium, before the insurance will pay any bills. For example, if you have health costs that total $10,000, and your insurance policy requires a $1,000 deductible, you will need to pay $1,000 up front before the health insurer picks up the rest of the $9,000 balance. <u>Higher deductibles can lower your monthly premium, but be aware of what it will cost you when you use the insurance.</u>
- **Co-payments** – A co-payment is a flat fee that you may have to pay for a specific health-related service. For example, typical co-payments may be $20 for a doctor visit, $50 for an emergency room visit, and $10-$40 for a brand-name prescription. We deal with co-payments here in prison on a regular basis. Any time we go to sick call, a lien is placed on our inmate trust fund account for $5 (which is the co-pay for medical service at the institution).

INSTRUCTOR NOTE

You'll need to judge how detailed the class wants you to get, and what they can grasp in the time frame you have. Some additional components to health insurance costs that you can bring up (but which is a little more complicated):

- **Co-Insurance**: Many plans also include co-insurance requirements, which is a percentage of the amount of the cost of covered health-related services that you pay directly to the provider after you have met your annual deductible. Typically this is around 20%, with the insurance picking up the remaining 80%

What this basically means is that you will be paying 20% of the medical bills, even after you pay your deductible. In other words, if you have a $500 deductible on a plan with 20/80 co-insurance and a $50 co-pay for an emergency room visit and you receive emergency services that total $20,000, you would pay your $500 deductible, a $50 co-pay, and then an additional $3,890 (for a total of $4,440) before the health insurance company will pay out the remaining $15,560 (if you have 100% coverage on that service).

- **Lifetime Maximum**: Many plans have a coverage cap called a lifetime maximum. This is the maximum dollar amount that the insurer will pay out for any services that you ever receive.

Most people skip over this part of their policy because the dollar amount generally looks so huge that it doesn't even seem realistic. If you have a lifetime maximum of $2 million dollars, that means that once the insurance company has paid out that $2 million dollars, it won't pay out any more claims for you. EVER. Granted, a lot of people won't ever receive over $2 million dollars in medical treatment, but suppose that a child under your plan gets leukemia. They may require extremely expensive cancer treatments and bone marrow transplant surgeries. It's a painful, scarring, and potentially fatal disease (although procedures are getting more and more successful at treating it), and the costs can equal $250,000 to $500,000 annually. Now, how long is it going to take to reach that lifetime maximum? There's a reason why so many charities exist for children with this disease. People simply can't afford to pay for the treatment, and they very rapidly exhaust their insurance payout. You want the number for this component of your insurance to be as large as possible or non-existant.

Some policies will also have **Annual Maximums**. This works similar to a Lifetime Maximum, but it applies every year. Some people will trade a Lifetime Maximum for an Annual Maximum and pay the extra premium cost. You need to be aware of what this number is as well. Again, with our example above, if your Annual Maximum is $500,000, you could easily hit that ceiling and no further medical procedures would be covered until the next calendar year.

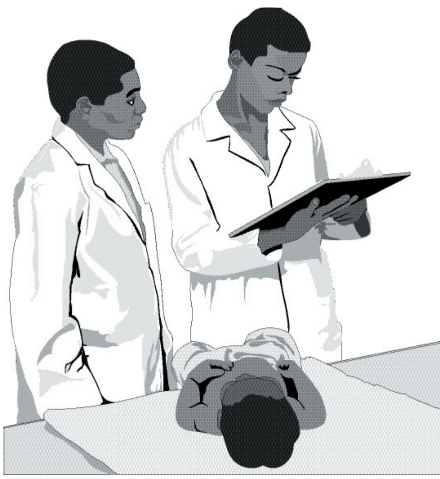
- **Pre-existing Conditions**: These are serious medical conditions that you have prior to purchasing an insurance policy.

It used to happen that if your child had leukemia and reached the lifetime maximum on one policy, you could shop for another policy with a different insurer. If that new insurance company could prove that your child had cancer before they sold you the policy, they could immediately exclude any of those treatments from coverage. As a result of the ACA, the vast majority of insurers can no longer exclude anyone from coverage for Pre-existing Conditions. They will still do what they can to limit their liability, but there are far more options now for people in serious need. It is possible and likely that the ACA will undergo siginificant changes. This particular portion of the law, however, is unlikely to change.

You need to be very aware of what the plan you purchase is going to cost you in any given situation. Surprises unfortunately happen in health matters and those surprises can get very expensive. Read the fine print before you sign the contract. **All of it.** Remember **KPC**. If you choose not to have all the knowledge you need to have about your policy, you are choosing not to have any power or control over your finances if something goes wrong with your health. Always keep in mind that the goal of the insurance companies is to pay you as little money as possible. Doing your homework here takes time. It takes effort. But, it's your money that you worked hard to earn. Work to give away as little as possible in every area you can, for the best possible return.

- **Medical coverage** - Medical coverage helps you pay for the cost of doctors and procedures ordered by doctors, like x-rays, lab tests, pharmaceuticals, and follow-up visits.
- **Hospitalization** - Hospitalization coverage helps you pay for the expensive cost of a hospital stay, including tests and procedures performed while you are a patient.
- **Major medical coverage** - Major medical coverage pays for large medical bills run up by surgery and expensive tests. You are probably not going to be able to afford a surgery that requires testing and a one-week stay in the hospital where the total cost, including the surgeon and various medications, could easily exceed $50,000. You need major medical insurance in case you need to pay large medical bills.

In order to determine what mix of these components is best for you, you have to know what your health care needs are and how often you may need health services. If you are managing a chronic condition like asthma or diabetes (which require frequent office visits and/or medication), you may want a plan with a higher premium and a lower deductible so you're not faced with frequent out-of-pocket costs. On the other hand, if you are relatively healthy and only need to deal with routine checkups or an emergency, you may consider a plan with a lower monthly premium and a higher deductible.



The bottom line is that getting sick or having an accident is very expensive. Just how expensive is Health Care? It is an unfortunate truth that the majority of bankruptcies in America are filed due to medical bills. The average cost of a trip to the emergency room for an adult is about $700 (not including any tests). Repairing a broken leg can cost up to $7,500. A major illness or surgical procedure can easily cost over $100,000. For example, this is an invoice for a hip joint replacement:

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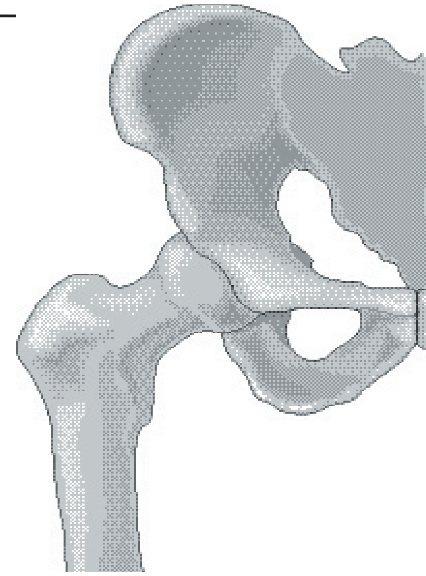
Hip Joint Replacement		
Account Number:	12345678-00001	
Date(s) of Service:	02/06/2015 - 02/08/2015	
Date	**Description**	**Activity**
	Room-Board/Semi	$6,000.00
	Pharmacy	$2,828.00
	Med-Sur Supplies	$334.72
	Sterile Supply	$405.08
	Other Implants	$53,283.20
	Laboratory	$48.00
	Chemistry	$348.00
	Hematology	$322.72
	Laboratory Urology	$34.80
	OR Services	$104,659.20
	Respiratory SVC	$15.35
	Physical Therapy	$957.21
	Evaluation or Re-evaluation	$214.29
	Self Administrable Drugs	$409.52
	Sub-total:	**$169,860.09**
3/5/15	UHC Contractual Inpatient	$67,944.04
3/5/15	UHC Payment	$100,068.70
Total Account Balance:		$1,847.35



The vast majority of people just don't have thousands of dollars laying around to pay for medical emergencies, and few of us plan to have a heart attack or a disease or a serious accident requiring trauma care. These are the 'sluggers' than can completely destroy the best, most disciplined budget. Health insurance helps us to pay for the health care that we need whenever these issues come up as well as helping us to pay for routine check-ups.

Health Care in the USA has changed significantly in recent years (and may change rapidly again after this writing) thanks to the Affordable Care Act (ACA), also known as "ObamaCare," but the basic function of this insurance is still the same. Thanks to the ACA, businesses that employ more than 50 people are required to offer health insurance to their employees or be faced with substantial tax penalties ($4,000-$6,000 per person). Called "Group Insurance," these policies keep costs down by dividing the cost between the business and the employees and by also dividing the risk. Group Insurance is almost always the best option because it costs less and pays better benefits. Smaller businesses don't face this penalty, but most will still try to offer some sort of insurance plan. Most employers actually want to take care of their workers. Business owners with only a few employees are usually even more interested in their employees' welfare. If you're able to take advantage of a health care plan through your employer, do so.

INSTRUCTOR NOTE

It's important to note that the information about the ACA is current as of November of 2016. With a new administration coming into the Presidency, it's possible that much of this information will change. The way that health insurance works, however, will very likely remain the same. So, the costs of insurance and the way it is purchased may change, but the basics of coverage will more than likely remain the same. The ACA, in other words, affects how health insurance is purchased and its availability. It does not, largely, affect how it functions (except in specific circumstances like pre-existing conditions).

Private policies, even when purchased under the "ObamaCare" exchange, are almost always much more expensive. As we mentioned earlier, all insurance companies make their money based on their assessment of risk. A 21-year-old in good health is much less likely to need expensive medical procedures than a 65-year-old chronic smoker. A group policy typically includes a broad range of workers with different ages and different health care needs. The risk of someone buying into a group insurance policy and actually needing expensive health care is low (on average). An individual person who buys a policy represents a much higher risk. People typically buy health insurance on their own because they need it, not because they might need it. In the past, many insurance agencies did not have any desire to offer personal insurance policies. They did so only because they were required to by various state laws, and they took every opportunity they could find to cancel those policies.

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The ACA (while very far from a perfect system) did a lot to balance the scales between group and personal health care. Insurance agencies are now required to work much harder to level the playing field. So, what are your options for buying health insurance on your own under the ACA?

To be clear, the ACA does not sell health insurance, but it does create a marketplace for Americans to buy subsidized private insurance. Policies can only be purchased through this marketplace during periods of open enrollment (which generally occur twice a year). When you use the marketplace, it will ask you for information about your location, family size, age, and smoking status (under the ACA, health insurance companies cannot take your gender or health status into account when calculating your costs, meaning that if you already have an illness it cannot be held against you in order to raise the price you pay). Based on this information, it will provide a list of options sorted much like Olympic medals (with Bronze, Silver, Gold, and Platinum plans, each with progressively better benefits and progressively higher costs) with policies listed from various Insurance companies.

Based on your income, you may also qualify for cost assistance. This assistance can take the form of a tax credit (to lower your monthly premiums) and cost reduction subsidies (which lower your out-of-pocket costs for things like co-pays and deductibles). The good news is that most Americans qualify for this cost assistance. After this tax credit, the average plan will generally cost less than $100 per month (average for 70% of enrollees was $82/month after the tax credit).

So, what is "affordable" health insurance? The ACA defines it as insurance costing up to 8% of your income (if you earn $1,540.38 a month working at Taco Bell, "affordable" would mean $123.23 per month for health insurance). After cost assistance, this could drop as low as 2% (or $30.81 per month in our example). Realistically, your cost would probably fall somewhere between those extremes. The average cost of coverage without subsidies for a Silver Plan in 2014 was $345/ month. After cost assistance (for the 87% of people who qualified for it), the average cost dropped to $69/month.

Job #2		
$8.25 per hour		
48 hrs/ Weekly Income		$396.00
(times 4.33)		
Monthly Income		$1,714.68
Less Withholding 15%		($257.20)
Mow 3 lawns on day off at $40 per lawn		($120)
Net Pay $1,577.48		
Expenses:		
31.7%	Rent	($500)
15.8%	Food	($250)
6.4%	Clothing	($100)
15.2%	Savings	($240)
11.4%	Utilities	($180)
5%	Probation	($80)
2.5%	Transport	($40)
3.7%	Tax Penalty	($57.92)
8.3%	Discretionary	($129.56)
100%	Total	($1,577.48)

The bad news about ObamaCare is that there is a tax penalty for anyone who does not have health insurance (either through their employer or individually through a private plan or the health care marketplace). The ACA requires everyone to have coverage or face this financial penalty. Exceptions do exist for people who can't afford insurance even with the cost assistance benefits, but most people earn too much to be exempted this way. As of 2016, the tax penalty for individuals who do not have health insurance is $695/year or 2.5% of their household income (whichever is higher). In our Taco Bell example, you would be paying an extra $695 in taxes for every year you didn't have health insurance. If you were a machinist earning $32,682.84 per year, you'd be paying an extra $817.07 in taxes.

The bottom line with any health insurance policy is to ask the necessary questions to determine what sort of policy you need and then determine what sort of policy you can afford. Does the policy include doctors that you can trust in its network? Does it include specialist care if you need it? Do you require prescription medicines? Will the policy cover my children? What is the claims process like? Do you prefer alternative health care methods like acupuncture or holistic treatments, and are they covered? Many health insurance policies will also include wellness programs to keep their members healthy and lower the costs for participants. All of these are important things to look at. Decide what's important to you and how much you're willing to pay for it.

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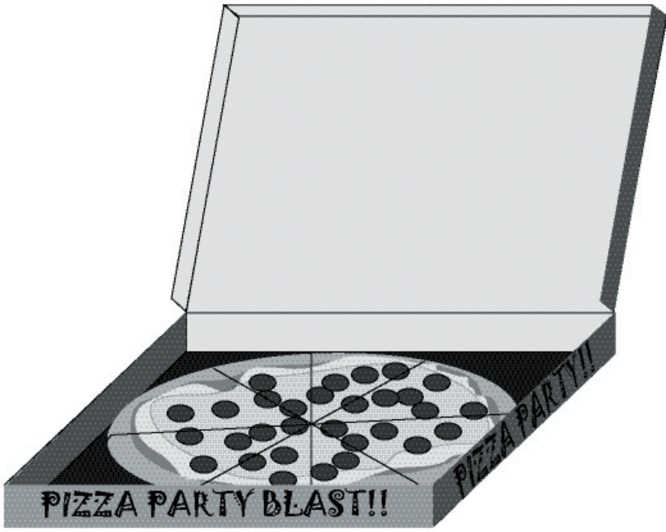
Perhaps more than any other category in this chapter, it is absolutely vital for you to be informed about health insurance. Spend the time to learn what you need to know about your health and your health care options.

Renters Insurance

People who rent an apartment, a room in a home, a trailer, or a condo often feel like insurance isn't something they need to worry about (some of them don't even know that renter's insurance exists!). They figure the landlord will make good if anything bad happens to the property. While the landlord is liable for a lot of things, they're not required to pay for your stuff if it gets burglarized or ruined in a fire, flood, or some other disaster. His insurance covers his investment (the building itself), not yours. As a renter, you need insurance at least as much as the owner! It's just too easy to have something terrible happen that wipes you out.

The good news is that renter's insurance is incredibly affordable. A $20,000 policy covering your furniture, computer, jewelry, clothes, and so on might only cost a couple hundred dollars per year, which you can typically pay for at $15-$20 per month.



For around the cost of one pizza a month, it covers you if your annoying neighbor forgets to turn off the tap and floods your closet full of suede shoes or if you accidentally leave the toaster on when you leave for work and set your curtains on fire. Renter's insurance will not only cover the repairs and replace the stolen or damaged items but also typically put you up in a hotel if your place is temporarily uninhabitable.

Most insurance companies offer renter's insurance, so consider starting your search with a company you already hold policies with, where you may receive a discount for buying additional insurance.

That thick packet you get when you ask for information on any insurance policy is long and complicated (and about as interesting as reading someone else's legal brief), but make sure you at least read the outline of it, generally the first couple of pages, to figure out what's actually covered. Sometimes certain acts of God or certain kinds of flood or fire damage aren't covered in the standard policy. You may need a rider if you live in an area that's prone to natural disasters (like flood or fire or hurricanes) or if you have a lot of expensive jewelry (over $1,000 worth).

After you get your policy, do an inventory of your valuables and how much they are worth. Take photos of your most valuable items, like furniture and electronics. Store your policy somewhere safe along with copies of the photos and inventory list. Ideally, put these in a safe deposit box at the bank or at a trusted friend's or relative's house, or scan everything and store it on the Cloud. You should also update your policy every year to include any new valuables; otherwise, if you get robbed, that new 75" TV you just got for your birthday will not be covered.

There's also another big advantage to buying renters insurance. Getting homeowner's insurance, when you someday buy a home, can be difficult. Many insurance companies only accept a limited number of new homeowner's policies each year, especially in coastal states like Florida. If you have a renter's policy with a major carrier like Nationwide, State Farm, or Allstate, converting to a homeowner's policy can often be easier because you are an existing customer already familiar to the agent and company.

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Homeowner's Insurance

Obviously, if you own a home, insurance is critical (and almost all lenders will require proof of homeowner's insurance in order to finance a mortgage) – and yes, it's more expensive – simply because you've got more on the line. (Title insurance is also almost always required to get a mortgage. It insures that you have all the rights to the property you're buying.) Your lender will let you know what the minimum insurance is, and then you'll need to figure out how much you want to buy beyond that.

Usually, the basic package (standard home insurance is called HO-3 or 'special insurance') will include theft, fire, frozen pipes, electrical shorts, trees falling through the roof, and that kind of thing. It also includes liability coverage, so if a friend falls on your property and breaks his arm, you're covered. If a tree branch falls off a tree on your property and lands on your neighbor's car, you're covered for that, too. What you want beyond the standard coverage will depend on where your house is. If you live at the foot of a mountain known for avalanches or your block is nicknamed 'Tornado Alley', you may want some additional insurance. Here in Florida, hurricane insurance is a typical addition.

The price of this additional coverage might give you pause: earthquake insurance can cost anywhere from \$100-\$3,000 per year depending on where you live, while flood coverage can cost over \$500 per year. You should consider whether the annual premiums cost more than potential repairs if disaster should strike. If you aren't sure what repairs would cost, you can call a local contractor and ask for a quote for hypothetical damages. In short, do the math, and if you decide not to have a specific type of coverage, make sure you have enough money in your emergency fund to cover those repair costs.

Incidentally, private insurers typically don't cover flooding at all, but you can buy federally sponsored protection from your agent through the National Flood Insurance Program. You should consider buying it even if you're in a low-risk area.

Once you determine your needs, you should shop around for the best price – never the other way around. Prices can vary widely. For example, the annual premium charged last year by 44 insurers for \$200,000 in-dwelling coverage on a brick home ranged from \$440 at Liberty Insurance to \$1,528 at Nationwide Property and Casualty. Call a variety of companies and get quotes based on your own situation. See if an insurance company you already use, like your car insurance company, would be willing to bundle home insurance for a lower rate.

INSTRUCTOR TALKING POINT

Use the internet to comparison shop for homeowner's insurance. It is a tremendous resource that can save you time, money, and a lot of headaches. Websites like Insure.com, InsWeb.com, and NetQuote.com will compare rates from different companies for you to save you even more time. Florida also maintains its own website with useful information for home owners as well as financial matters in general (myFloridaCFO.com). There are also apps that can assist you in tracking down the best rate. Take the time to comparison shop in order to get the best value for your money.

Finally, choose an insurer that has the financial strength to be there should you ever need to file a claim. You can do this by checking ratings at TheStreet (www.thestreet.com/insurers/index.html), and stick with insurers rated A (excellent) or B (good).

You can also reduce your insurance cost by raising your deductible. If you have some savings in the bank for home emergencies (and you should if you own a home), you can raise your deductible to match the amount you have set aside. This is an easy way to lower your premiums, with the security of knowing you have enough money on hand to cover the deductible if need be. Remember that, if a loss is only a little bit higher than your deductible, you should consider not filing a claim, because it could cause your premiums to go up or flag you as a customer worth dropping-especially if you make several small claims over a relatively short period. Homeowner's insurance is for losses in the thousands, and that's when you should call your insurer.

Chances are you will never need to file a major claim, but if you do, experts say a difficult part of the process is remembering what was lost or stolen. So do an inventory of your belongings ahead of time. Include receipts, with videos or photos, and record the serial numbers of major items. You can store the information for free on the website of the Insurance Information Institute, at iii.org/software. Also, keep copies of important documents in a fireproof safe, a bank safe-deposit box or with someone you trust.

INSTRUCTOR TALKING POINT

You probably won't be surprised to find out that your homeowner's insurance premium might increase after you file a big claim, but did you know that the insurer might go a step further and cancel your coverage or refuse to renew it? It isn't just claims that can torpedo a policy, either. Insurers sometimes terminate a policy or raise premiums to extremely high levels for much more surprising reasons. Would you believe that if you buy a trampoline your insurer can cancel your Homeowner's policy?

Having a policy terminated can be more than a minor inconvenience. When you seek to replace your policy elsewhere, other insurers might quote very steep premiums or decline to offer coverage at all. That's because when an insurer terminates a policy, the insurer typically notes that it has done so in a database that other insurers will check before approving you. That policy termination can scare off other companies from insuring you.

Here are some surprising reasons your homeowner's insurance could be terminated or your premiums pushed up…

- **CREDIT SCORE**: A drop in your credit score could result in non-renewal of your policy or a dramatic increase in your premiums. How dramatic? In 37 states, people with poor credit pay more than double what people with excellent credit pay. Only three states – California, Massachusetts and Maryland – prohibit homeowner's insurance issuers from considering credit scores. Insurers have determined that people who are responsible with credit also tend to be responsible with home *maintenance* and make fewer claims.

  If your insurer tells you that your credit score is one of the reasons your policy is not being renewed or your rates are rising, obtain your credit report and remove any inaccurate information that might be pulling down your score (take Credit and Debt Management to find out how to do both of those things). If you find inaccuracies on your credit report, inform your insurer of this and ask whether it would reconsider its decision if you get the problem sorted out. If not, resolve the credit problem as quickly as possible and then ask to be "re-rated" by the insurer.

  Helpful: If there is no quick or easy way to improve your score, apply for homeowner's coverage through small and midsize regional homeowner's insurance issuers, which are less likely to check scores. An insurance-shopping website, insurance broker or your state department of insurance could help you locate these smaller issuers (we mentioned the websites in the last INSTRUCTOR TALKING POINT).

- **DRIVING INFRACTIONS:** Believe it or not, speeding tickets can affect your homeowner's insurance. Insurers have concluded that irresponsible drivers tend to be irresponsible home owners, too.

  There are no hard-and-fast rules here, but if you get more than two moving violations that put points on your driving record in a year – or even one serious citation (such as for a DUI) – you could have trouble maintaining your homeowner's insurance at a reasonable rate. It's worth investigating whether your state offers any way to quickly remove some of the bad-driving "points" that will appear on your record, such as by taking a driver-safety course. It's these points – not the violations themselves – that catch the notice of homeowner's insurance providers.

- **INSURANCE CLAIMS MADE BY YOUR HOME'S PREVIOUS OWNERS:** If the home's previous owners filed multiple claims that could increase the risk that your policy will not be renewed if you make even one or two claims. This is particularly likely if the claims are similar and point to a serious underlying problem with the home, such as wiring issues that have led to multiple fires.

  What to do: If you have owned your home for less than seven years, request the property's Comprehensive Loss Underwriting Exchange (CLUE) report. You can obtain this report for free as often as once per year at PersonalReports.LexisNexis.com (select "Insurance Report" under "FACT Act Disclosure Reports"). If you discover multiple claims by the prior owners, you should consider that an additional reason to pay for covered repairs of modest size out of pocket rather than file claims (By law, CLUE reports can include claims only up to seven years old – less in some states – so if you have owned your home longer than that, there's no reason to check for former owners' claims.)

  Helpful: Before purchasing a home, insist that the seller provide you with the property's CLUE report. This report could point to underlying problems, and should factor into your decision to buy.

INSTRUCTOR TALKING POINT

- **SMALL CLAIMS:** It isn't just big claims that scare off home insurers. Repeated small claims can lead to termination, too. Insurers sometimes consider policyholders who file repeated small claims to be nuisances who are not worth the trouble.

  What to do: Increase your deductible to at least $1,000 and preferably $2,000 or $2,500 to remove the temptation to make small claims. Put the money this saves you into a savings account to pay for minor home repairs.

- **ASKING QUESTIONS:** Call your insurer to discuss the possibility that making a claim could lead to an entry in your CLUE report. Having a number of CLUE entries that your insurer deems excessive can cause nonrenewal.

  Do not contact your insurer to discuss a potential claim unless it is extremely likely that you will actually make a claim. If you feel you must call your insurer to discuss the possibility of making a claim, speak in hypothetical terms and make it very clear that you are not *currently* making a claim.

  Example: "I'm not filing a claim, but in theory if someone had the following happen, would it be covered?" There is anecdotal evidence that phrasing things this way reduces the odds that the call will be logged into your CLUE file, though it still is possible.

- **HOME-MAINTENANCE ISSUES VISIBLE FROM THE ROAD:** Your insurer might be watching you. Insurers sometimes conduct unannounced drive-by inspections of properties. If your property is deemed to have maintenance issues, you might receive a letter threatening cancellation or nonrenewal if repairs are not made within 60 or 90 days.

  Inspectors often focus on things such as missing shingles or broken gutters that can lead to greater home damage and insurance claims, but even basic upkeep issues such as an un-mowed lawn could trigger unwanted insurer attention. To insurers, such things can be signs that the home is not being well-maintained in other, more important ways.

  Warning: It is especially important for landlords to keep the portion of property that is visible from the road well-maintained – drive-by inspections of rental properties are particularly common.

- **TRAMPOLINES, TREE HOUSES, SWIMMING POOLS, AND DOG BREEDS THAT ARE CONSIDERED DANGEROUS:** Many homeowners do not realize that their policies require them to inform the insurer if they obtain one of these potential liability risks. Some policies prohibit these things altogether or have detailed rules that must be followed if they are obtained – perhaps a fence is required around a pool, for example. Read your homeowner's policy carefully before obtaining any of these things.

  Similar: Many Homeowners' policies restrict or prohibit renting out the home, such as through AirBNB. Violating this rule could result in policy cancellation or nonrenewal.

WHAT TO DO IF YOUR POLICY IS TERMINATED:

Homeowner's insurance policies can be terminated through either cancellation or nonrenewal. Cancellation means that the policy is ended during a contract period. Nonrenewal means that the insurer declines to continue covering the property when the policy term expires.

Issuers generally must provide at least 30 0r 60 day's notice. Start shopping for a new policy as soon as you learn that your current one is ending – other issuers might be wary once the termination is on your record, so it might not be easy for you to find coverage at an appealing rate.

If all the quotes you receive are significantly higher than what you previously paid, also contact your state's insurance department to see if it has a high-risk insurance pool for homeowners. (To find it, go to NAIC.org, select "Map" and then click on your state.)

This coverage could be expensive and/or limited, but it might be your best option if private issuers do not want your business.

An example of Homeowner's Insurance:

<u>What a storm taught me about Homeowner's Insurance</u>*

"I got home around 4:30 p.m. on the day of the storm, and almost immediately my husband and I looked up at the sky and saw a tree coming straight toward us. It seemed like slow motion – you never think something like this is going to happen to you.

"Suddenly, the tree was in the middle of the room. Now it was raining in our house – just water pouring in. We went and got every garbage pail we could find and put it under where the rain was falling. And, of course, we had no power – no one did – so we had to do all of this in the dark.

"We tried to just take Hurricane Sandy in stride. In fact, I actually feel lucky, for a few different reasons: no one was hurt, and we were able to sleep in our bedroom that night. But the damage from the storm – physically and financially – was significant."

-Gail, 47, Upper Brookville, NY

In the end, removing the tree from their house alone cost $17,000, plus another $10,000 for the additional eight trees that fell on their property. They also ended up needing a new roof on that part of the house. If they hadn't been insured, they would have had to swallow those costs. All that compared to the few hundred dollars a month they paid for the coverage.

<u>Cost of damage without insurance</u>: $27,000 tree removal + $25,000 house repair = $52,000 total
<u>Cost of damage with insurance</u>: $2,500 deductible + $3,500 annual insurance premium = $6,000

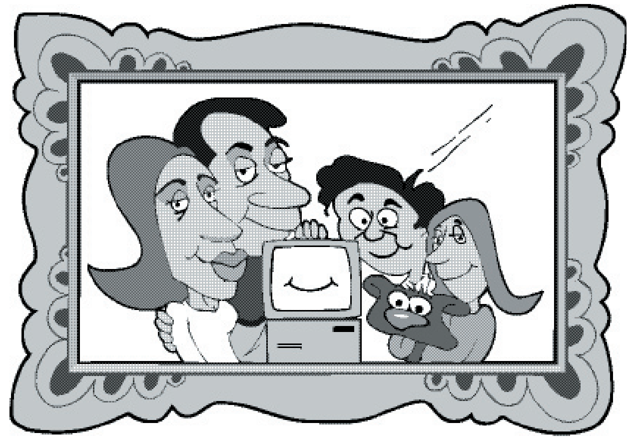
What's most important to remember with Homeowner's insurance is not to underinsure your home. About 64% of the homes in the U.S. are underinsured. That means the face value of the policy will not be enough to reconstruct the dwelling completely. The average shortfall is 19%. A home should be insured for what it would cost to rebuild it (minus your deductible). You can ask your insurance agent for a customized estimate of your home's replacement cost that accounts for its unique features, construction details, and age, as well as any costs due to local building-code requirements.

In short, insure your home for what it's worth. It is, after all, usually the single most valuable asset you will own.

Life Insurance

If you are unmarried and have no children you do not need life insurance.

Do you agree? The thing to remember here is that most people misunderstand the purpose of life insurance. Life insurance is not about you. It is not about providing for your burial, debts or medical costs (those are covered by your health insurance). Life insurance is meant to provide security for those who you leave behind, those people who depended on your income to survive. If you are married you need life insurance. If you and your wife decide to have children you need more life insurance. If you have other dependents that rely on your income to meet their monthly needs, you need life insurance. Life insurance will pay benefits if you die. These benefits will help your wife, children, or dependents continue on in their lives with some measure of financial security.



As with all types of insurance, Life Insurance has its own terms (the language of Life Insurance). Some of the words that you will see used in your policy are:

- **Beneficiary** – a person named to receive the income or inheritance from a will, insurance policy, trust, etc.
- **Accidental Death Benefit** – This is an additional amount payable to the beneficiary, should your death occur due to an accident.
- **Death Benefit** – Also called "Double Indemnity" The limit of insurance or the amount of benefit that will be paid in the event of your death.
- **Living Benefits** – Also called "Accelerated Death Benefit" This feature allows you, under certain circumstances, to receive the proceeds of your life insurance policy before you die. Usually this is used in the case of terminal or catastrophic illness, the need for extensive long-term care, or confinement to a nursing home.

INSTRUCTOR NOTE

Again, you'll need to judge how detailed the class wants you to get, and what they can grasp in the time frame you have. Some additional terms you might see with Life Insurance (but which are a little more complicated. You may want to save these to reference only if the students have questions):

- **Convertible**: Term life insurance that can be converted into permanent insurance regardless of an insured's physical condition and without a medical examination. The individual cannot be denied coverage or charged an additional premium for any health problems.
- **Elimination Period**: The time which must pass after filing a claim before a policyholder can collect insurance benefits. Also known as a "waiting period."
- **Mortgage Insurance Policy**: In life and health insurance, a policy covering a homeowner with benefits intended to pay off the balance due on a mortgage upon the insured's death, or to meet the payments due on a mortgage in case of the insured's death or disability.

As with all types of insurance, you, as the buyer, need to beware. You need to go into the transaction armed with as much knowledge as possible. The danger here is just like with any other insurance - overinsuring. Look for things that are added into the policy which may not apply to you. If you don't need it, don't pay for it.

INSTRUCTOR NOTE

In particular, one type of Life Insurance that companies will try to sell you on is Juvenille Life Insurance. If you've just had a baby, chances are that you will get an offer to buy that infant life insurance. The pitch: If a horrible illness befalls him or her, the policy will provide you with a lump sum to put toward burial costs or unpaid medical bills. A number of firms, including **Gerber Life Insurance, Northwestern Mutual Life Insurance**, and **State Farm Insurance**, offer a version of life insurance for babies.

In addition, many policies for adults allow policyholders to buy a rider that covers all the children in a family. Premiums average $213 a year. But the chances of a child dying are extremely slim – only one in 3,000 children perish in an entire year. Remember that Insurance companies work on their assessment of risk. They are basically betting on the likelihood of you dying. In a child's case, their risk is very, very low. Meaning that your shelling out cash to them in exchange for something that they are very unlikley to ever pay anything back on.

Instead of getting a Juvenile Life Insurance plan, consider increasing you own coverage. It may be unpleasant to think about, but if the primary breadwinner dies, the financial consequences are far more severe, and there is a much greater likelihood of that happening.

Another supposed perk of these policies: The plan allows parents to get a head start on saving money for their children. Typically companies promise to set aside a portion of premiums that kids can tap into once they reach age 18. But the savings often don't materialize, since they tend to accumulate only a couple thousand dollars of savings over the lifetime of the plan. You can produce better long-term savings for your kids by investing money directly into a 529 college-savings plan. These accounts allow you to build up college savings without paying tax on the investment earnings.

The first two questions most people ask when looking into life insurance coverage are often: "How much will it cost?" and "How much do I need?" This can be tricky because there are several different types of life insurance, with term life and whole life insurance being the two most basic. There are others. The cost is unique to the person and depends on the type of policy you choose, the amount of coverage you want, and things like your age and overall health. Comparing plans online is a good way to get ideas of what prices you may be looking at for different plans, but to get a customized plan that fully meets your needs and your budget, it is best to work directly with an agent.

What factors do life insurance companies look at to figure out their risk in insuring you?

- **Age**: Life insurance rates will go up as you get older.
- **Health**: Do you smoke? Expect to pay more. Do you have any chronic conditions (including diabetes or high blood pressure)? Expect to pay more.
- **Gender**: Are you a man? Expect to pay more. Women live longer, statistically, and will pay less for life insurance because of that.
- **Occupation**: Remember the secretary versus the blind sky diving instructor? It makes a difference.
- **Exams**: Most life insurance policy will require some sort of physical exam to determine if you have any conditions like diabetes, high blood pressure, heart diseases, etc… There are "no exam" policies out there, but they are typically more expensive.

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There can be some differences in your life insurance costs based on your state (and even where you live within the state) as well. Life insurance companies use "mortality tables" (also known as Actuarial Tables) to help predict the benefits they are likely to pay in a given year. Why? Because the amount they collect in premiums must be less than what they pay out in benefits. These tables help them make sure that they won't end up in a deficit. Some things that they might take into account based upon your region include:

Whether there is a high rate of obesity in the area

If the area experiences a high rate of deadly natural disasters like earthquakes or tornadoes

If the area is prone to certain diseases like malaria or black lung disease

If the area has a high mortality rate due to crime (expect higher premiums in Chicago or New York than in Priminger, Iowa)

Even with all of these factors, where you live doesn't affect your rates all that much. Even if you live in a region prone to earthquakes and high crime, your cost will be affected more by your age and health than where you choose to live.

Let's look at the different basic types of life insurance.

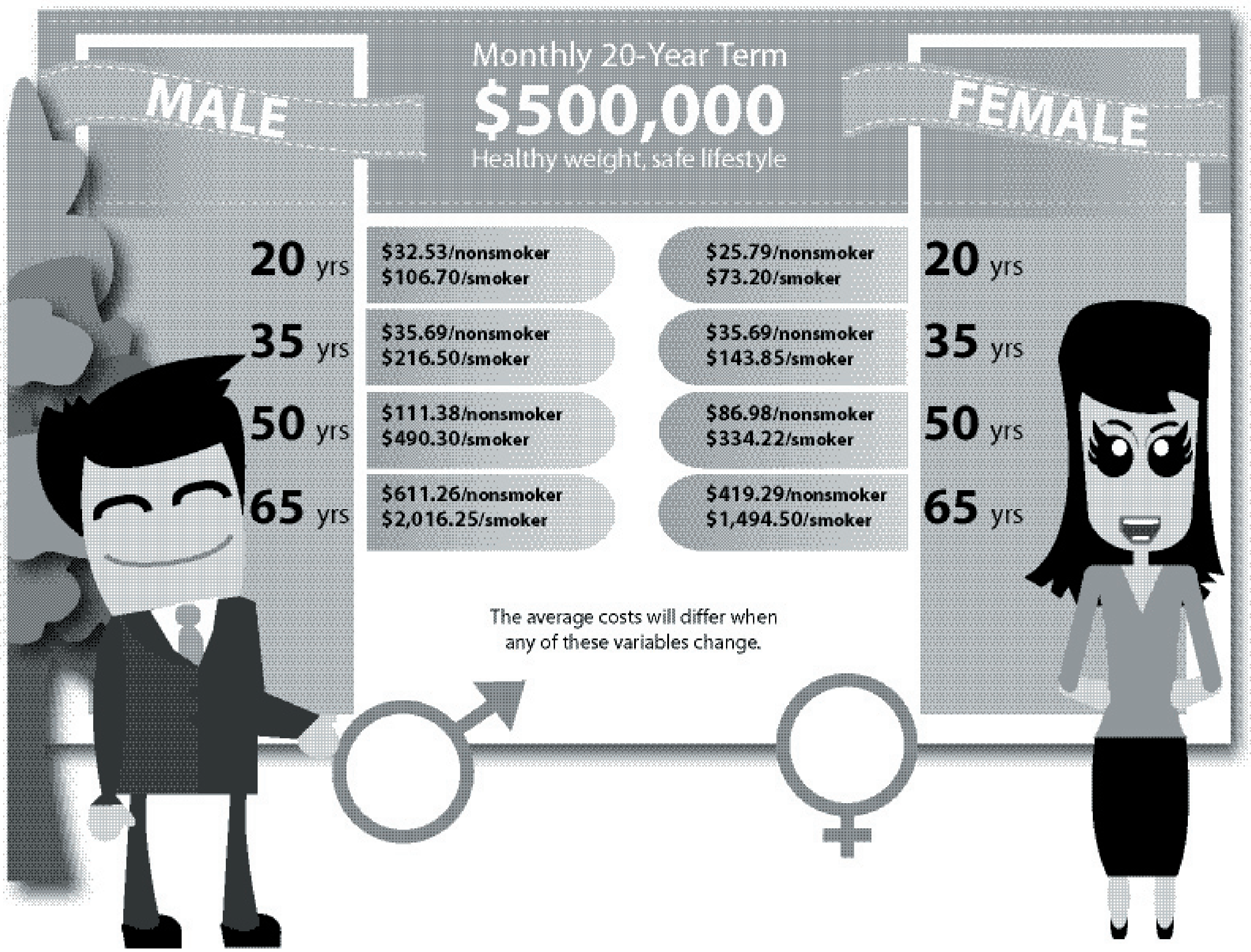
Term Life Insurance

Term life insurance is a death benefit only type of life insurance. With term insurance, you are setting an amount of coverage (this can be any amount that the insurance company considers reasonable, say $50,000, $100,000 or $250,000. It could even be more) that will be paid to your beneficiary if you die within a certain period of time (again, this can be anything the company thinks is reasonable, but is most commonly 10, 20, or 30 years). The insurance industry calls this period of time a "term." Your coverage only exists if you die within that term. Put simply, if you die within the term, the benefit you agreed on is paid to your dependents. If you outlive the term, no benefit is paid out. It's the simplicity of these policies that keep the costs down.

Term policies generally offer the most protection for the lowest cost because it is so specific. Fortunately, many policies of this type are also renewable, meaning you can purchase them again for the same term even if your health or circumstances have changed (although your cost might increase). The cost of term insurance also gets higher as you grow older. Put another way, if you are 30 years old and buy a 30-year $100,000 term insurance policy the cost will be lower than if you wait to buy the same policy when you are 40 years old. The reason for the increase in cost is because you are more likely to die between the ages of 40 – 70 than 30 – 60. After age 70, people cannot have term insurance.

How much does term insurance cost?

This chart assumes that both of these people are a healthy weight and do not live a "hazardous lifestyle" (such as someone working in underwater demolitions or someone engaging in promiscuous sex). They both want $500,000 worth of life insurance, and they want to pay monthly for a 20-year term policy.



The average costs will differ if any of the variables change. For example (as of 2016), a 35-year-old female non-smoker would pay an average of $61/month for $1,000,000 worth of life insurance with a 20-year term. That would drop to $23.90/month for $250,000 worth of life insurance for a 20-year term.

Whole Life Insurance

Whole life is life insurance with a savings plan. It is usually more expensive than term insurance. You can have a whole life insurance policy for as long as you live. You can use the money built up in the savings account when you get older (exactly what age, how much and all those sorts of details depend on the policy). This type of plan also pays benefits to your family when you die. How it pays out benefits is, more or less, identical to term insurance.

The average cost for a healthy (as in not living a "hazardous lifestyle") 35-year-old female non-smoker, buying $250,000 worth of whole life insurance and who wants to keep a monthly "level pay" (meaning the same monthly payment for the duration of the policy), would be about $188.36/month (as of 2016). If you're a man, you can expect to pay more.

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The way this works is that you pay your premium each month. A portion of that (say $23.90 in our example above) goes to pay the insurance cost. The rest of the payment ($164.46) goes into an investment account that is managed by the insurance company. This investment account grows over time. As we saw, costs go up as you get older. With a whole life policy that is true as well, but the amount that you pay actually stays the same. Once your monthly premium no longer covers your insurance, the insurance company begins drawing from the investment account to cover the difference. In the vast majority of cases, this evens out by the time the policy expires.

One of the benefits of this type of policy is that you are allowed to borrow against the amount of money built up in the investment account over time (the "equity"). This gives you a way to borrow against your own life insurance policy, providing a cash-value benefit.

But, is this really a benefit? One thing to keep in mind is that it's *your money* being kept in the investment account. The insurance company is not interested in taking on any more risk than they absolutely have to, so they're not going to invest your money in anything that might have a high return (they will typically invest in CD's or low-risk bonds). Additionally, if you "borrow against" the cash value of your policy, you are really paying an interest fee to borrow your own money. On top of that, the insurance company will typically charge you an annual management fee to manage your money for you (often 2-3% per year).

The real benefit of whole life insurance is that it allows you to maintain a steady payment for the length of the policy. That's all.

Which is the best type of life insurance for you? Many people with young families buy term insurance. They get more protection for less money. There's an old piece of advice followed by most financial planners: "buy term and invest the difference".

Here's an example: You are considering two life insurance policies for $100,000. One is a whole life policy and one is a term policy. The whole life policy costs $500 per year and the term policy costs $250 per year. The whole life policy costs more because the extra premium goes into the investment account and is charged the annual fee with little real investment growth. The better solution is to buy the term policy for $250 per year and then put the extra $250 you would have spent on a whole life policy into a mutual fund on your own. Invest it yourself. With a mutual fund you have excellent investment managers, often with far better performance results than insurance companies, and the annual management fees are lower, usually .50 – 1.50%. There are also no restrictions to accessing your money in the mutual fund. You don't have to pay to borrow your own money. By earning more from your investment you can allow for the difference in the increasing cost of term insurance and still have money left over.

Money Saver! Buy term insurance and invest the difference.

How to lower your life insurance costs:

Overall, life insurance is a little different from the other types of insurance that we've discussed in this chapter. With auto or health insurance, you can increase your deductible or alter your coverage to lower your costs. There are a few things you can change from policy to policy in life insurance (such as the amount of the total benefit), but because health and lifestyle play a key role in determining your life insurance rates, the biggest things you can do to lower your payments have to do with improving your health and reducing your risk of chronic conditions like diabetes or cancer. Perhaps the single most significant thing you can do to reduce your life insurance cost is to not smoke, but there are many more things you can do as well.

- Maintain a healthy weight to reduce the risk of obesity and related conditions
  - Get a body mass index (BMI) check done
  - If you have a high BMI, work with a health professional to lose weight
- Maintain your heart health to reduce risk of hypertension, heart attack, and stroke.
  - Get an annual physical
  - Check your blood pressure regularly along with your cholesterol and triglyceride levels
  - Work with a doctor to improve your numbers, if needed
  - Reduce stress, improve your diet, and increase exercise
- Manage your blood sugar to reduce the risk of diabetes.
  - Request a blood sugar test
  - Obtain a diet and exercise plan to help manage blood sugar levels

Your career choice and hobbies also affect your life insurance rates. An accountant will pay significantly less than a rodeo clown. As always, knowledge leads to power and control. Do you have a wife? Do you have children who would like to go to college? The death of a loved one is a terrible thing to have to live through. We grieve and mourn, and we worry about how we will go on. If you have dependents relying on you for financial support, you need life insurance. It's one way you can relieve some of the stress on them if you leave them behind and give them something to go on with. Life insurance, as mentioned above, is different because the ways to manage its costs are not simply dollar adjustments. They are also excellent ways to go on living.

Auto Insurance

You *must* have auto insurance if you own a car; it's the law now in every state. There are two reasons that states require this insurance. First, it protects you, the car's driver. Second, it protects other people or property your car may damage in an accident. Simply, auto insurance protects you and limits your liability. As with all insurance, the cost is based on several risk factors. Some of these are:

- **Gender** – Male drivers tend to engage in riskier behavior and will pay more
- **Age** – Younger drivers, statistically speaking, get in more accidents
- **Demographics** – People living in high-crime areas pay more than those living in low-crime areas
- **Theft-deterrent systems** – If you have an alarm on your car, you'll pay less for insurance
- **Safety devices** – Air bags and anti-lock brakes both work in your favor by keeping you safer and lowering your insurance bill
- **Accident Prevention training** – Some companies offer discounts if you take drivers education training

- **Previous driving record** – If you have had a history of insurance claims (either for or against you) this will count against you. This also includes traffic tickets, suspended licenses, and so on.

- **Distance driven each day** – Simply put, the less you drive the less likely you are to get into an accident
- **The make and model of the insured car** – Do you own a Mercedes SL63? Is it red? It is statistically more likely to get stolen or into an accident than a green Kia Soul.
- **Car color** – Believe it or not the color of your car can also affect your rates. Red cars are statistically more likely to be stolen than white ones.
- **Credit score** – If you have a low credit score you are statistically more likely to engage in risky behavior (and, thus, are more accident-prone). It also shows a higher probability of filing a claim against the agency.

INSTRUCTOR TALKING POINT

Life post-prison can be a nightmare when it comes to insurance. Existing regulations state that if you have a gap in time when you are not carrying an insurance policy it triggers red flags for the insurers to not issue a new policy to you. As we mentioned above, all insurance is based on risk and some of the most important risk factors that insurers look at when considering a new policy are **credit score, last policy,** and **income**.

In other words, if you have been in prison for some time and have not needed or had insurance, it may cause you to lack the ability to obtain insurance in the future for a **REASONABLE AMOUNT OF MONEY**. Getting insurance on your car is far more important than getting the car itself. The cost of *not* having insurance is far more detrimental and dangerous than not having a car.

Some people might think that just owning a car is enough, that's wrong. You have to have insurance. Insurance and car ownership go together like food and water, you need both if you are going to have a car.

This tier system will exhibit a brief snapshot of the different variables that are necessary to obtain a policy.

1 Tier

Insurance companies today judge you based on your socioeconomic stability. What does that mean? If your credit score is low, if your income is weak, and if you've only held a job for a short time you will have a harder time getting a policy. Those are some of the biggest challenges to overcome. Some other variables that come into play that are in the second tier.

2 Tier

The car loan not exceeding the value of the collateral. Due to so much insurance fraud, new laws have been put in place to objectively protect you as the consumer. Yet, they may also make it more difficult to obtain insurance.

3 Tier

You must carry auto insurance if you have a car, by law. Failing to do so can result in suspension of driving privileges, and cancellation of any registration to motor vehicles and possible jail time.

4 Tier

Having insurance is your blanket protection from being sued for virtually everything you own and potentially anything you may own. Present assets and future assets are all liable to be taken if you don't have insurance.

In Florida, the law requires that all licensed drivers have a minimum of $10,000 Personal Injury Protection (PIP) and $10,000 Property Damage Liability (PDL) as long as you have a valid Florida driver's license plate for a vehicle with at least 4 wheels registered in the state. The DMV can suspend your license for up to three years or until proof of Florida insurance is provided, whichever comes first. If your license is suspended, a reinstatement fee must be paid (of $150-$500) once you provide your proof of insurance. In addition, most auto insurance companies will not even give you a quote, much less insure you, if you are currently uninsured and driving a car.

Florida is a "no-fault" state. This simply means that each driver's own insurance provider is responsible for damages and compensation arising from an accident, regardless of who is at fault. If you are determined by a police investigation to be at fault in an accident and do not have insurance, the Florida Bureau of Financial Responsibility will automatically obtain a final judgment from a Florida court against you. The judgment will be immediately enforced and your license, tags, and registrations will be suspended for up to 20 years. It's very important, therefore, that you do not let your insurance lapse.

PDL and PIP coverage will satisfy Florida laws, but you will find additional coverage to be very necessary. Some auto loans will even require you to have "full coverage." Full coverage does not mean that you have the maximum coverage in every category. It simply means that your policy has some coverage in each of the major categories. Check with your loan agent to see what minimum limits they require.

How much Auto Insurance should I get?

This depends a lot on your situation. Of course, you need to purchase PIP and PDL to comply with the law, but these are the bare minimums and will rarely cover all your bills if you end up in a bad accident. If you get an auto loan, you will also need to comply with the terms of the loan, but keep in mind that the requirements the loan agency sets are designed to protect their asset, not you.

INSTRUCTOR NOTE

There is a lot of terminology to keep track of in the different types of insurance. Automobile insurance is particularly full of strange sounding language, mostly because it is so omnipresent. If anyone who has a car legally has to have insurance, think about the number of auto insurance policies that are floating around out there. We talk about most of the important aspects of auto insurance terminology below, but there are others. One that students may want to be aware of is called **Gap Coverage**. Gap insurance provides coverage for the difference between what you owe on a car and the insurance company's estimation of the actual cash value. IF you drive a new car off the lot after putting very little money down, the actual cash value will be substantially less than what you owe to the finance company. Gap insurance makes up the difference. Gap insurance is also typically used when leasing a new car.

Is Gap Coverage necessary? It's not required, but it can be useful in protecting you if you get into an accident very quickly after purchasing a car. While no one plans on doing that, not many of us actually plan for accidents at all. The real answer here is that it depends on what you can afford and the car you are insuring.

In the same category is **Income Loss Coverage**. This insurance is sometimes a part of PIP. It simply replaces your paycheck if you are unable to work due to accident-related injuries. It's important to know if your policy includes this as part of PIP or if it is a separate cost.

You'll need to judge the class as to whether this additional information will be useful.

When you buy auto insurance, remember to CYA – cover your assets and your family first. Your most costly bills from an accident generally come from the other people involved. **Bodily Injury Liability** protects you from this by covering medical expenses, rehabilitation, and even funeral costs (should it come to that). It covers the other driver and his/her passengers and even injured pedestrians (as well as lawyer's fees). The minimum to shoot for with Bodily Injury is $100,000 per person ($300,000 per accident). You may need to adjust that down to make your premium more affordable, but that should be your goal.

Property Damage Liability (PDL) is one of the two types of insurance required by Florida law. It will cover the damage you cause to other people's property (be that another car, a house, a light pole, etc…). The state has a minimum required level of coverage of $10,000, but most new cars average $22,000. That leaves you footing a $12,000 bill if you total someone's new car. Your goal for PDL should be at least $25,000 in coverage.

Personal Injury Protection (PIP) is also sometimes called "no-fault" coverage. This is the other coverage required by Florida law. The law requires you to have at least $10,000 in PIP coverage. This covers your medical needs and the medical needs of any passengers in your car, up to the $10,000 level of coverage, per person, per accident. This is meant to prevent the court system from being clogged up by small medical insurance lawsuits. Unless your health and disability coverage is very low, you don't really need much more than the minimum here.

Uninsured/Underinsured Motorist sounds like a strange thing to need in a state that requires everyone to have insurance by law. Shouldn't everyone have insurance? Why would I need to worry about this coverage? To put it bluntly: Does everyone follow the law? What about hit-and-run accidents? Do those ever happen? This type of coverage will pay for things like medical, rehabilitation, funeral, and pain-and-suffering costs of the victims in your car if you get struck by a hit-and-run driver or by someone who doesn't have enough insurance to cover your costs. It will also cover family members of your household as pedestrians. Your goal number here is the same as for Bodily Injury Liability ($100,000/person, $300,000/accident).

Collision insurance is not required by law but since it protects your car in the event of an accident, it is foolish not to have it. If your car is involved in an accident and it's your fault, unless you have collision insurance your car doesn't get repaired by the insurance company. However, if your car is involved in an accident and it's the other drivers fault, your car gets repaired by the other driver's insurance company under their property liability policy. If you have a new car loan, they will require this coverage.

Comprehensive insurance is also not required by law. Comprehensive insurance covers damages to your car that are not caused by a collision. The coverage can insure your car from fire and theft, flying or falling objects, explosions, vandalism, earthquakes, windstorms, hail, water, floods, civil commotions, riots, and collision with a bird or animal. The cost of comprehensive car insurance varies depending on how many different situations you wish to insure against. Full comprehensive insurance, covering you against all of the aforementioned things might cost $300 per year. If you limit your comprehensive coverage to say fire and theft only, the cost might only be $90 per year. Just $90 a year to sleep at night knowing that if your car is stolen it will be replaced seems like a pretty good decision.

For both Collision and Comprehensive, you'll have to choose a deductible. The higher the deductible, the more you will save on your premium, but be careful not to make the deductible so high that you won't be able to afford to pay it. That defeats the purpose of having the insurance in the first place. But, a deductible of around $500-$1000 on each is a good goal. Over and above all the money saving hints mentioned before, the single best way you can slash your auto insurance premiums is to increase your auto insurance deductibles. Just be aware of the cost to you should you get into an accident.

If your car is worth less than $3,000, Comprehensive and Collision probably aren't worthwhile. Over time, the money you'll pay for the insurance will likely exceed the payout, even if your car is totaled. Keep the value of your car in mind when you are insuring it.

Car medical insurance is not required by law but it's important to have if your car has caused an accident. This type of insurance covers your medical expenses over and above the PIP amount. Medical insurance also covers any passengers in your car over and above the PIP amount. If your car is in an accident and a passenger in your car is seriously injured, the medical costs could be tens of thousands of dollars. Car medical insurance covers you financially.

Other things your auto insurance policy might cover are things like **towing and labor**, **rental car replacement**, and **glass breakage** coverage. These are all optional and you should decide if they are useful to you or not. Most auto clubs like AAA will provide towing services and are usually cheaper than adding the cost to your insurance. Rental insurance generally only adds a few dollars a year to your premium, but if you have a second car that you can use in a pinch, save yourself the money. Things like glass breakage can add as much as 20% to your premium. If it's not automatically built in to the policy, avoid it.

If your premium is still too high, you do have options to lower it. Ask your agent if you qualify for any of the following:

- If you drive your car fewer than 6,500 miles a year, check whether you're eligible for as much as a ten percent rate cut.
- If you quit smoking or drinking, find out whether your company offers reductions for non-smokers or teetotalers.
- Look at your payment plan. Some companies will offer a discount based on the way you pay for your policy. Paying your entire yearly bill at once instead of month-by-month could lead to a discount.
- Be loyal to your Insurance Agent. If you have more than one car and/or also have a homeowner's or renter's insurance policy, keep in mind that many companies will offer a discount based on the number of policies you have with them.
- Check the Internet! A reputable Internet insurer could save you up to fifteen percent (whether they are GEICO or not).
- Farmer's auto insurance discounts are available if you happen to be a farmer or rancher and only use your vehicle on the job.
- If you're not married and you insure your car in your family's name, stating that you are the principal driver, you are likely to pay a lower insurance premium than if the car is registered in your name and you are listed as the sole driver.
- If you have a family and more than one car, insure all the family cars under the same policy: A second family car generally can be insured at a discount of about twenty percent on the grounds that two cars in one family are likely to be exposed to less risk than two single cars would be.
- Don't file collision claims which are under or just barely over your deductible, or you may lose your "good driver" discount. In other words, if your damages are only $1,000 and you have a $1,500 deductible, don't file a claim. You'll be paying for it all out of pocket anyway, and the only thing a claim will do is increase the cost of your insurance.

The last thing you can do if your insurance costs are still too high is to buy a cheaper car. If you're buying a new car, keep in mind that rates on a "muscle" or high-performance car may run 20-50% higher than average. If you buy an inexpensive or low-powered car, though, you will be charged a lower than average premium.

What does Auto Insurance look like in action?

INSTRUCTOR NOTE

It's a great idea to go over this example in detail. Having one of the students read the story out loud (or doing it yourself with a bit of drama) is a good way to get the class interested and laughing. It can break up the monotony of going over so many insurance details. It's also a good way to illustrate exactly how auto insurance performs in action.

As an example let's say your policy looks something like this:

Bodily Injury Liability: $25,000/$50,000 (the first number is how much the insurance will cover per person; the second number is how much it will cover per accident)
Property Damage Liability: $25,000
PIP: $10,000 (in this case, this number indicates how much the insurance will cover per person, per accident)
Collision: $10,000 (with a $500 deductible)

You're in your sleek, slate-grey Kia Soul, with the window rolled down on a clear sunny day. You've got your shades on, and all of a sudden your phone chimes with a message. As you reach for the phone, it falls off the passenger seat onto the floor, so you stretch and grab across the floor for the phone. When you sit back up, you see that you have a message from Tasha, a photo of her, scantily clad at the Round Holiday Inn, with a text under it that says, 'Are you coming?'

'Fuh'shizzle!' you quickly text back. When you look up from the screen, you notice that you've drifted over to the wrong side of the road and are now headed straight toward an oncoming 18-wheeler that wails out its horn to warn you. You drop the phone and swerve back onto your side of the road but end up clipping the back of a Ford F150. He hits a fire hydrant, spins out into the ditch and rolls, mud and broken fiberglass flying up into the air, while your car skids sideways right into a light pole. Ears ringing, you feel blood on the side of your head. Steam and smoke is pouring out from somewhere, blocking most of your vision. Glass and shards of debris litter the road. You see cars parked in the middle of the intersection ahead, people standing around or rushing over to you. Feeling woozy, you look up into the face of a grandmotherly woman who looks very concerned. She pats you gently, worriedly on the shoulder.

"Are you okay, sweetie?" she asks, bending down to see the extent of your injuries.

"Um… Tell Tasha… I might be a couple minutes late," you reply.

In this example, you've hit a Ford pickup truck and a light pole. Both you and the other driver were injured as well as the other driver's daughter who was riding in the truck with him. Both the other driver and his daughter survive but need to go to the hospital. Their medical bills come to $14,000 for the driver and $37,000 for his daughter. Fortunately, the F150 was not new, but you caused $17,000 worth of damage to it. You also caused $7,000 worth of damage to your own car. The light pole was damaged, costing $7,500 to repair, and a fire hydrant was damaged and needs to be replaced for $1,000. You were seen by paramedics at the site of the accident and fortunately have only a mild concussion and some lacerations, but you need to be transported to the hospital for stitches. Your medical costs come to $2,750.

Your **Collision** insurance covers the damages to your Kia Soul. You have $10,000 worth of coverage, but you only did $7,000 worth of damage, but you also have a $500 deductible. This means that the insurance company will pay for $6,500 of the damage while you will need to cover the other $500.

You did $17,000 worth of damage to the Ford F150. This is covered by your **Property Damage Liability**. Fortunately, you have $25,000 worth of coverage, so the insurance company pays for all $17,000. Unfortunately, you also caused $7,500 worth of damage to the light pole and $1,000 worth of damage to a fire hydrant. This is also covered by your **PDL**, but $17,000 + $7,500 + $1,000 = $25,500. Your **PDL** will cover all but $500 of it.

Your medical costs are covered by **PIP**. In this case, you're well below the $10,000 limit. Your insurance will cover all $2,750 of your medical bills.

The medical costs of the other driver and his daughter are another matter. This is covered by your **Bodily Injury Liability**. Unfortunately, both of them had extensive injuries requiring some serious medical procedures. The driver's medical bills came to $14,000 and his daughter's treatment cost $37,000. All of the driver's bills are covered by your insurance because it falls well under the limit of $25,000 per person. The driver's daughter, however, had injuries above what your insurance company is liable to pay ($25,000). The total amount that your insurance company would pay for their medical costs would be: $14,000 + $25,000 (which is the maximum amount per person) = $39,000. If the other driver has **Underinsured Driver's** insurance, his own insurance company may cover the difference. If he does not, and he wanted to get the rest of his money for his daughter's hospital bills, he could sue you for the remaining $12,000.

So, in our scenario, your total out of pocket cost would be $1,000. Unless the driver wanted to sue you for the rest of his damages, in which case your costs would be $13,000. Compare this to the total cost of the damages: $86,250. You can quickly see here why it is extremely important to have auto insurance.

The moral of the story is: *Don't text and drive.*

And, have enough auto insurance to meet your needs. Remember what it is for. Automobile insurance (and this also goes for other types of insurance) was never intended to help you budget. It was never designed to pay for small repair bills for which you ought to be able to budget routinely. Common sense should urge you to trade off a higher deductible for a higher upper range of liability coverage. Had you increased your **Bodily Injury Liability** to $50,000/$75,000 and increased your deductibles to say $1,500 each in our example, all of the medical expenses for the other driver and his passenger would have been covered. Your cost would have been $3,000, but you also wouldn't have been sued for $12,000. $3,000 is a lot, but it is a more manageable bill than $13,000.

INSTRUCTOR TALKING POINT

Once you have all the information you need, you need to weigh the costs and the benefits of coverage options in relation to your needs and your budget. Consider some of the following questions: Should you purchase collision insurance as well as liability coverage? How much liability coverage is appropriate for you? How much underinsured/uninsured motorist coverage is necessary for you? The knowledge you gain by comparison shopping and looking at all the details of different policies will give you the power to control your financial situation in insuring your automobile. Use that power to get the most value for your money.

Some resources that may help you with additional information to make informed decisions: [Write out on the board]

- www.consumerreports.org/cro/car-insurance/buying-guide.htm
- www.floir.com/Sections/PandC/Automobile/default.aspx
- www.myfloridacfo.com/division/consumers/understandingcoverage/guides/documents/AutoToolkit.pdf

Always remember that, as a consumer, you have vast power. But, no one is going to hand that power to you. There is a certain math that goes on between buyer and seller. The seller NEVER wants that equation to be equal. Their goal is to separate you from as much of your money as possible (and put that money in their own pockets). Don't leave that decision to them. Be an informed buyer. Use your knowledge to make that equation as even as possible. If you can, bend it in your favor. If nothing else, don't forget that this is YOUR money. If someone is going to separate you from it, make them work for it.

Money Saver! The important point to remember about automobile insurance is that it is intended to protect you against a financial catastrophe, especially if you do not have other means of protecting yourself against such a catastrophe.

INSTRUCTOR TALKING POINT

Are there other types of insurance you can purchase? Absolutely! As we mentioned before, if someone wants to insure it, someone else will be willing to sell them insurance to cover it. The price may be extreme, but you will be able to find a company to insure your hands for $1 million dollars, if you so desire. Do you need other types of insurance? That depends on you, but remember not to get too much insurance or you'll be paying for coverage that you don't need. Some examples of policies that you can safely skip:

Tuition Protection Insurance

An insurance policy aimed specifically at parents: tuition-protection insurance. The policies typically allow you to get back some tuition money if you child gets sick, has to withdraw from school, or gets injured – but not if Junior fails to meet academic standards. If he flunks out, you get nothing. Tuition is expensive, so it's understandable why parents would want some guarantees. But, this insurance isn't always a good deal. Most colleges already offer some kind of refund if a student drops out because of a medical condition. What's more, the policies set serious restrictions; some won't refund tuition if the withdrawal is due to mental health or if a student simply drops out because of disinterest or some other reason.

Identity-Theft Insurance

Identity theft is the number one crime in America. So, naturally, a wide range of companies offer some form of insurance against identity theft, particularly credit-card theft. Some include credit monitoring and will send alerts if a new account is opened under your name or there are sudden moves in account balances. Some even offer to cover any expenses fraudulently charged to credit cards. Other companies offer broader coverage, such as cash to cover expenses associated with identity theft.

But such coverage is unneeded because credit cards *already come* with built in identity-theft protection. Most cardholders aren't responsible for any unauthorized or fraudulent charges on a card and issuers provide free credit-monitoring tools, which render the extra coverage unnecessary. In addition, some firms have come under fire for overstating the effectiveness of their products. **LifeLock**, which offers identity-theft protection starting at $10 per month, is particularly infamous for this. They agreed to pay $11 million to the Federal Trade Commission and $1 million to 35 state attorneys general to settle charges that the company made false claims to pitch its services.

INSTRUCTOR TALKING POINT

Payment-Protection Insurance

This coverage is offered by credit-card issuers. The promise: If you lose your job or get sick, the issuer will waive finance charges and minimum payments. These policies, simply, aren't worth it.

There isn't hard data tracking exactly how many issuers are offering this service, but analysts say that banks have started to offer it in larger numbers, in part to recoup revenue lost from the series of law changes beginning with the Credit Card Accountability Responsibility and Disclosure Act of 2009. The law restricts certain billing practices and "siphoned fee revenue." PPI allows those banks to charge you money so that you can pay for their revenue losses. Isn't that kind of them (and generous of you)?

Some credit-card companies are pushing the plan to cardholders without disclosing its restrictions. Ronald Washington, a military veteran who lives in the Bronx, N.Y., said he purchased payment-protection insurance from Discover Financial Services, assuming they would make his credit-card payments if his pre-existing injury prevented him from working. He says he discovered months later that he never qualified for the insurance because he already was injured when he applied. "I was never told that at all," Mr. Washington says. "Why would they take my money if I didn't qualify anyway?"

The answer, of course, is 'why wouldn't they?' It's free money in their pocket. The practice of enrolling consumers in a PPI policy without full disclosure has been made illegal in other countries. As of 2016, the UK passed their own legislation which required banks to refund a portion of PPI charges to consumers who had been victims of this practice. Recent legislation here in the US is examining these practices as well, so it's a good thing to beware of.

Cancer and Critical-Illness Insurance

Insurers offer two types of policies designed to supplement existing health-insurance coverage: cancer policies and those that cover a broader range of critical illnesses. The problem: Many are riddled with exclusions and doesn't cover the most common form of the illnesses they claim to address. For instance, some cancer-insurance plans exclude skin cancer entirely, while others won't cover basal-cell skin cancer, the most common kind.

The plans range in cost, with premiums between $200 and $350 a year for healthy people. In addition, some of the policies might not be hefty enough to cover expenses if a policyholder actually gets sick. Some critical-illness plans don't cover common illnesses such as cancer, or set strict limits on the number of illnesses they do cover. Take **Aflac**'s **Lump Sum Critical Illness Insurance**. Their plan covers only one illness within a 180-day period.

Before purchasing one of these policies, look to see when the benefits expire and exactly what they cover.

Divorce Insurance

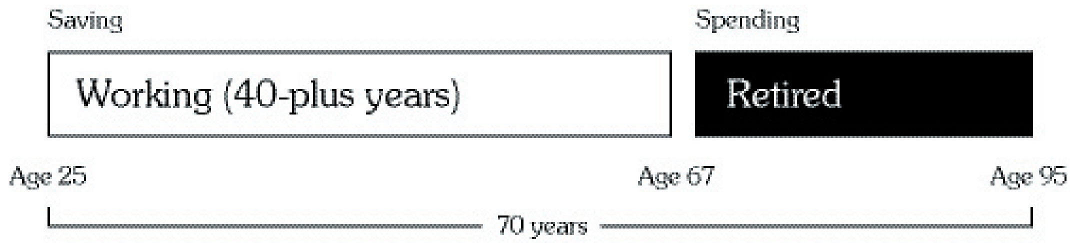
One firm is offering protection plans in case "happily ever after" doesn't pan out. Roughly 22% of women and 21% of men over the age of 15 have been divorced, according to the most recent data from the U.S. Census Bureau.

In response to this "obvious need," **SafeGuard Guaranty** rolled out a divorce-insurance program called **WedLock**. For $15.99 a month, you can secure $1,250 in coverage, which can be used to cover the costs of divorce or related expenses. The only problem is that couples have to wait four years before they can cash in the policies. That means if you get divorced before your fourth anniversary, you get nothing.

Divorce insurance is unnecessary since you could just set aside money into a general emergency fund to cover those types of costs (and you won't have to wait four years to get it).

Chapter 7 - Golden Years

Think of retirement this way: You work for approximately forty years to fund seventy-plus years of your life.



Are we all going to live to see 95? No. But, even if we only live eighteen years into our retirements, that's still a whole lot of time. If you don't put aside income for those non-working years as soon as possible, well, it is not going to be pretty. Saving for retirement is major and everyone needs money to fall back on in later years. To fully retire in your sixties, you'll need LOTS of money, so if there's one thing you do immediately upon receiving an income, it should be ot save hard and fast for retirement. Retirement cannot be neglected, despite the other financial responsibilities tugging at you.

Maximize your dollars

Remember when we talked about compounding interest back in Chapter 2? Let's say you have a spare dollar. How do you best maximize it? Thanks to that compounding interest, $1 in your retirement account will yield exponentially more than $1 in a savings account. If you have it in an account that yields a 6% return, in forty years, it will be worth $10. That probably doesn't sound like a lot, but think about the effect on a larger scale: put aside $100,000 for retirement and it could grow to $1 million. While paying down debt and saving for emergencies are smart money moves, too, your retirement dollars can bring some serious value.

Retirement is becoming a growing problem in America. On the plus side, we're living longer, but most of us are not prepared to handle that financially. The stats on retirement are just crazy: 30% of American workers plan to work until they're over 80 years old. 80? Really? Do you want to spend all that time laboring and work yourself into the ground? Why not think about reaching a point where we start to think about relaxing and enjoying the rest of our days, instead? They call them our 'Golden Years' for a reason, and they come around as soon as we hit 67 years old or so. Considering that many of us will have been working since we were about 18 (some of us even earlier than that!), that means that we will have been putting in our sweat and labor for nearly 50 years. It's time to start enjoying life. Beyond that, what if you can't work at eighty because your body or mind can't swing it? Most of us here haven't exactly been taking it easy and leading the healthiest of lives. You will have had a whole lifetime of hard work by then. Why not make sure you can enjoy the payoff?

The real, unfortunate fact is that the majority of people don't plan. Have you not saved anything yet to retire with? You're not alone. 49% of Americans have no money at all saved for retirement. Beyond that, 69% have no comprehensive financial plan. They set no goals and live only from hand to mouth. What about those of us who do plan ahead and start thinking about retirement? Of those, 22% make up their own estimate for a retirement goal, and 12% just guess. The remainder actually makes some good decisions. You want to be one of those.

Most young people don't like to think about getting old, but it's important to start thinking about it as early as possible. Retirement goals let us make the most out of our lives for as long as we live. Retirement savings goals are big goals. And often, big goalposts can be intimidating and stop you in your tracks. It's nothing to be ashamed of, it's human nature. You may think that an extra 1 percent in monthly 401(k) contributions will hardly make a dent. Or that putting aside $25 a week into an IRA won't really matter. Wrong. So before we actually crunch some numbers, let me just say this: every little bit helps. Do what you can. Make progress. You'll get there. It will be harder for some of us than for others, but it is rarely every impossible.

How much money do I need to retire?

So, how much money are we talking? Let's get a little more specific on how big a nest egg you should be aiming for. Think of annual retirement needs in terms of replacement value: what percentage of your current income will you need in order to replace not having an income for each year of retirement? This percentage will depend on your personal situation of course, so once you look at the numbers, you have to ask yourself, "Can I see myself living on *x* number of dollars a year?"

During retirement, there are expenses that tend to decrease (for example: you might have paid off your mortgage, student loans, and you'll definitely have paid off your consumer debt – if you've taken and paid attention in courses like Credit & Debt Management. You should also no longer need to financially support your grown children). But, there are also some expenses that tend to increase (for example: health care for your aging self and trips around the world). Given these competing factors, we generally estimate that you'll need to replace at least 70% of your current income to stay above water. We've crunched the numbers to show you what that looks like at a few income levels.

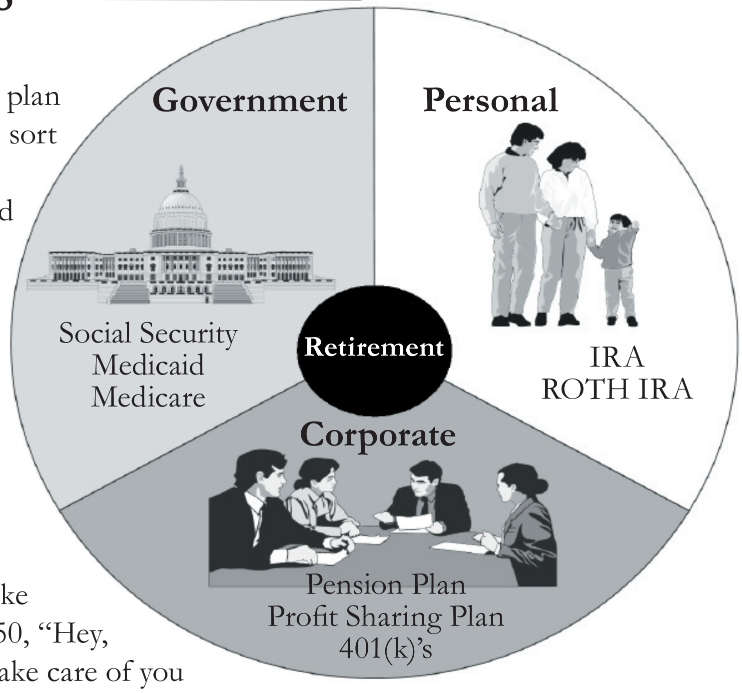
Annual Current Salary	Retirement Salary in Today's Dollars (replacing 70% of your current salary)	Retirement Salary in Future Dollars (replacing 70% of your current salary with 3% annual inflation)	Target Nest Egg (assuming you'll need your retirement salary for 20 years)
$35,000.00	$24,500.00	$59,467.93	$884,732.64
$50,000.00	$35,000.00	$84,954.19	$1,263,903.77
$65,000.00	$45,500.00	$110,440.44	$1,643,074.91
$80,000.00	$56,000.00	$135,926.70	$2,022,246.04
$100,000.00	$70,000.00	$169,908.37	$2,527,807.55

INSTRUCTOR NOTE

It can be worth revisiting the story we told back in Chapter 2 about Theresa and inflation (on page 42 of this Instructor manual or 23 of the Student Manual). Go over the story again at this point in order to explain this chart and why the retirement money you need is more than what you would need today.

So, how do we do that?

In the past, the golden years of retirement were funded by three sources. The first source was a pension plan provided by their employer, the second source was some sort of government subsidy like Social Security or Medicare, and the third source was whatever monies the retiree had stashed away in savings or investments accounts. Over the past few decades, the first two sources, corporate pensions and government subsidies, have changed or been reduced so significantly that a person looking to retire today can't count on them for much in the way of retirement income. Why did corporate and government retirement funding change? *Liability.*



A corporate pension plan is a *defined benefit plan.* What does that mean? It means that when a company like General Motors(GM) said to one of its employee's in 1950, "Hey, thanks for working for us for twenty years, we want to take care of you when you leave and provide you with an income to enjoy in retirement," GM had defined the benefit to the employee. "Providing income" meant that GM had to set aside money in 1950, from its profits, into a separate investment account, manage the investment, and make sure that the money grew sizably enough to provide the employee with an income, starting in 1970, for the rest of his life. That presented several liabilities for GM. The first liability was the need to set money aside for the employee's retirement plan. The second liability was hiring and paying a money manager to invest and manage the money for twenty plus years. The third liability was a big one: covering market losses. The fourth liability was the biggest of all. In 1950, the average American worker retired at 60 and died at around 65. The retirement funds were an obligation for an average of five years or so. As the number of employees at GM grew from a few hundred to tens of thousands, and the average person started living much longer, retiring at 60 and living until around 77, the liabilities got bigger and bigger. GM and many other American companies found themselves with lots of liability from the simple concept of trying to do the right thing. In the 1980's and 1990's corporations just couldn't afford to offer pension plans to their new employees anymore. There are still employers that offer pension plans, but they are limited and not very common (generally the result of belonging to a union).

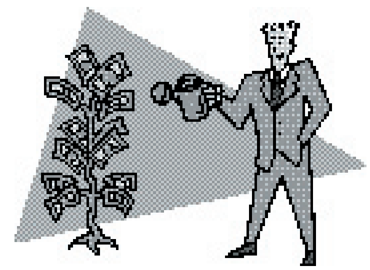
We'll talk about Social Security later, but the short version of the story is that for this generation, and future generations of Americans, our options for retirement funding are significantly reduced. The U.S. Government saw the direction things were going in decades ago and it didn't want a bunch of poor retirees in America for one simple reason: poor people need government support. They needed a solution and so created some retirement plans that would help Americans save for their own retirement, a kind of booster shot in the arm for the average worker. As a result, today there are many retirement plan options including: **IRA, ROTH IRA, 401(k)**, and **ROTH 401(k)** plans.

IRA

IRAs are investment accounts that are held and managed by what is known as a "trustee." The kinds of institutions that offer IRAs, and are legally considered trustees of your account include: banks, credit unions, brokerage firms, insurance companies, and mutual funds. In other words, the bank that you hold your retirement account with is considered the "trustee" of your IRA.

> **IRA**
>
> *Individual Retirement Account*

IRAs were created to encourage people to save for retirement by providing two big tax incentives: tax-deductible contributions to the account and tax-deferred compounding until the funds are withdrawn. Here's what that means: Say you earn $35,000 for the year; you would then pay federal income tax of 15% ($5,250) based on your income.



However, if you choose to contribute $5,500 to your IRA you would have still earned $35,000, but you get to deduct $5,500 from that because of your IRA contribution, so for tax purposes you only have to claim an income of $29,500. 15% income tax on $29,500 is $4,425.

That means you keep $825 more in your pocket ($5,250 - $4,425 = $825). That's one benefit. The other is that the $5,500 you put into your IRA grows each year and you don't have to pay income tax on that growth until you withdraw the money. That benefit is called tax-deferred growth.

How much can you contribute?

You must have earned income (that includes wages, tips, commissions, and self-employment income but NOT income from interest, dividends, or property) to be able to put money into an IRA or ROTH IRA and you must be under age 70½. You can choose to make contributions to an IRA, including a ROTH IRA, every year. Contributions are completely voluntary, so you can make them in whichever years you choose. You could contribute some this year, skip next year, and contribute again the next, or you could contribute every year if you choose.

You can deduct your IRA contributions even if you don't itemize deductions when you file your tax returns. Deposits in an IRA can be made right up to the time a federal income tax return is due for the previous year, which for most people means on or before April 15.

Great! I've put all this money into my IRA, but when do I get to take some out?

With an IRA, you may begin between withdrawing between the ages of 59½ and 70½. If you dip into your IRA account before you reach 59½, the IRS will stick you with a penalty tax of 10% on the amount you withdraw (that's on top of the tax you'll pay on the amount of money you take out). There are exceptions to this rule: If you suffer a major medical disability, if you are a first-time home buyer, or if you need to pay for tuition, you can withdraw your money without paying the penalty (though, again, you will still be responsible for the tax). If you die, your beneficiaries can also withdraw the funds from your account without penalty. On top of that, you must start withdrawing no later than the end of the year in which you reach 70½ (which will happen automatically according to a formula if you don't do it voluntarily). Why? The government wants its tax dollars.

An advantage to keeping as much money in your IRA as possible for as long as possible is that the balance still in the account continues to grow on a tax-deferred basis. Once withdrawals start, the money you take out is taxed just like ordinary income (if you withdraw $35,000, for instance, you'll be paying taxes on $35,000 worth of income that year – 15% as we mentioned before).

ROTH IRA

There are alternatives to a traditional IRA. The U.S. Government (in particular, a Senator named Roth) recognized that not everyone was interested in the tax advantages of a regular IRA. So, the ROTH IRA was created to give the average worker even more incentives to save for retirement.

The ROTH IRA does not offer tax-deductible contributions or tax-deferral like the traditional IRA. This means that the money you put into a ROTH IRA cannot be deducted from your current income taxes; however, the benefits you do get from a ROTH IRA are even better. Five years after you open a ROTH IRA, all withdrawals are tax-free (as long as you are at least 59½ years old). ROTH IRAs are more attractive than traditional IRAs to people paying lower federal income tax rates because they don't need the tax deduction as much as they need the tax-free growth.

To bring this benefit into better focus, consider the following example: If you bought $10,000 worth of Google stock when it went public in your ROTH IRA, then sold it ten years later, it would be worth $1,000,000. You could take the entire $1,000,000 out of your ROTH IRA once your reach 59½ years of age, and it would be completely tax-free. That's a terrific retirement savings benefit!

Transferring IRAs

One other point with IRA's: You are permitted by the IRS to change trustees of an IRA as often as you want, as long as you don't receive the funds yourself and transmit them elsewhere. In other words, you can't handle the money (until you withdraw it). The money has to be transferred directly from your account at one institution to your account at another in a process known as "rolling over". The one exception to this requirement is a once-a-year right to personally withdraw your IRA funds and hand-deliver them to another institution. You are also allowed to keep those funds for sixty days prior to rolling them over into a new IRA account. If you keep any part of that money and transmit the rest to an IRA, penalties and taxes are imposed on the portion that you kept.

What this means is that nothing in an IRA investment is forever. You have flexibility, with the opportunity to reinvest in another IRA if and when market conditions change. Each contribution to an IRA is independent of any other, so that you can invest in many different plans if you choose (although the total must stay within an annual limit).

Are IRAs my only option?

We talked earlier about companies wanting to take care of their employees and their past use of pension plans to do that. Those plans created huge liabilities because they were defined benefit plans. Today, companies still want to see their loyal employees do well in retirement, but they don't want to worry about the financial liabilities. So, working with the government, the 401(k) plan was created.

401(k)

The 401(k) plan is a *defined contribution plan.* The company defines their contribution, how much money they wish to put towards your retirement, and you decide how to invest that money. Think about the liability equation now. Once the company contributes money, they're off the hook. You now take on the liability of choosing your investments; if those investments lose money it's *your* loss, not the company's. If your money doesn't grow to a large enough balance to take care of you in retirement, that's *your* problem, not the company's.

That sounds a little lopsided in the company's favor, doesn't it? But, there are also huge advantages to having a 401(k) plan for the employee. A 401(k) is a tax-deferred retirement savings plan in which employees of private corporations may contribute a portion of their wages up to a maximum amount per year (set by law). Employers may contribute a full or partial matching amount.

What does that all mean? Remember our Taco Bell job from Chapter 1? With that job, our income was $385.92 per week. That's not an enormous salary, but we were still able to meet all our basic needs and put some money away into savings. In fact, we were putting $240 per month away in our savings account (or about $55 per week).

Job #2		
$8.25 per hour		
48 hrs/ Weekly Income		$396.00
(times 4.33)		
Monthly Income		$1,714.68
Less Withholding 15%		($257.20)
Mow 3 lawns on day off at $40 per lawn		($120)
Net Pay $1,577.48		
	Expenses:	
31.7%	Rent	($500)
15.8%	Food	($250)
6.4%	Clothing	($100)
15.2%	Savings	($240)
11.4%	Utilities	($180)
5%	Probation	($80)
2.5%	Transport	($40)
12%	Discretionary	($187.48)
100%	Total	($1,577.48)

Would a company like Taco Bell offer a 401(k) plan to its employees? Absolutely. There may be rules (must be full-time, must have worked for the company for over 1 year, etc…) on who can partake, but over the past 20 years, 401(k) plans have exploded in terms of popularity. In fact, about nine out of ten large employers (companies employing over 500 workers) provide 401(k) plans for their workers. Any individual Taco Bell might not employ more than 500 people, but nationwide they employ many more than 500. It is a multi-national corporation, and corporations love 401(k)'s because they allow the retirement program to be handed over entirely to you, the employee.

Let's assume that Taco Bell offers a 401(k) plan with an employer match of $1 for $1, up to 3%. That means that for every paycheck you receive, you can choose to put money into the 401(k) account. In our example, 3% of our income is $11.58. So, up to $11.58, Taco Bell is going to match it. So, if you put $5 into your 401(k) plan, Taco Bell will put $5 into your 401(k) plan. If you put $11.58 into your 401(k) plan, Taco Bell will put $11.58 into your 401(k) plan. If you put $25 into your 401(k) plan, Taco Bell will put $11.58 into your 401(k) account. Whatever you put in, Taco Bell will match it, up to that 3% maximum.*

Can you afford to put $11.58 away? That's taking $50.14 out of your regular savings account, but you'd still be saving $189.86 a month. And, you'd be building income for your retirement years. On top of that, every time you put that $11.58 away, $23.16 is going into your 401(k) account. To put it another way, it's **free money**. Take advantage of it! Even if the amount seems small, small amounts add up.

Employee contributions to a 401(k) plan and the earnings on those contributions have all the same advantages of a traditional IRA; they are tax-deductible, with all taxes deferred until retirement withdrawals begin. So, you do not pay taxes on the money you contribute to a 401(k) plan, which means you can contribute into your retirement account money that you would otherwise pay out as taxes. In our Taco Bell example, if you put in 3% of your paycheck every week you will have contributed $602.16 to your 401(k) plan by the end of the year (and with matching, that means that $1,204.32 went into your account). When you file your taxes, you get to deduct that. Instead of paying taxes on $18,000 for the year, you will be paying taxes on $17,397.84.

Second, your earnings on your retirement account are tax-deferred. That means you earn a return on money that you otherwise would have paid out in taxes. The result is that you can build up a much larger retirement nest egg using a 401(k) account than you otherwise could. A matching 401(k) plan is an offer that is too good to refuse.

*** Note: These figures are used as examples and do not necessarily represent actual figures used by Taco Bell.**

ROTH 401(k)

Just like the ROTH IRA, Senator Roth wanted to provide additional incentives for people that are in lower tax brackets and so are less interested in the tax deduction than the tax-deferred growth. Let's face it, there's not a huge difference in the tax rate between $18,000 and $17,397.84. So, the ROTH 401(k) plan was created.

The ROTH 401(k) works just like the ROTH IRA. It offers no tax-deductible contribution or tax-deferral; instead the employee and employer contributions grow tax-free as long as they stay in the account for at least five years. All the other features of the 401(k) are the same for the ROTH 401(k).

Money Saver! Don't leave money on the table!
If you remember nothing else from this chapter, know this golden rule: *maximize your employer match.*
If your employer matches your 401(k) contributions, you should be putting away **whatever amount it takes** to get the full company match. If you don't know what amount your employer matches, ask. If you're that Taco Bell worker and the company will match your $11.58, do it! It's **FREE MONEY!**

Not only that, with a dollar-for-dollar match, you're getting a 100% return on your investment. It may hurt a little to see the size of your paycheck reduced, but it's a small price to pay for having your employer help fund your life. Failing to maximize this benefit is leaving money on the table. It's saying, "No, thanks. I don't need all that money."

"But, I can't save, because…"

If your employer doesn't offer a matching 401(k), that doesn't mean you're off the hook with retirement savings. On the contrary: it just means that it's even more important to contribute as much as possible. Putting money away for retirement conjures up a whole range of excuses. Have you ever woken up in the morning and hit the snooze button? We tell ourselves all kinds of things to keep from having to do something that we do not want to do (it's too cold out, it's still early, I'll be fine if I just wait a couple more minutes, and I only barely just got to sleep…). Same thing with retirement savings. Let me make this point (and we'll come back to it later): **Time is NOT on your side**. So, do not fall into the trap of hitting the retirement snooze button. We do all the same things to try to put it off for tomorrow. Do not listen.

What are some of the most common excuses we tell ourselves to avoid saving for retirement?

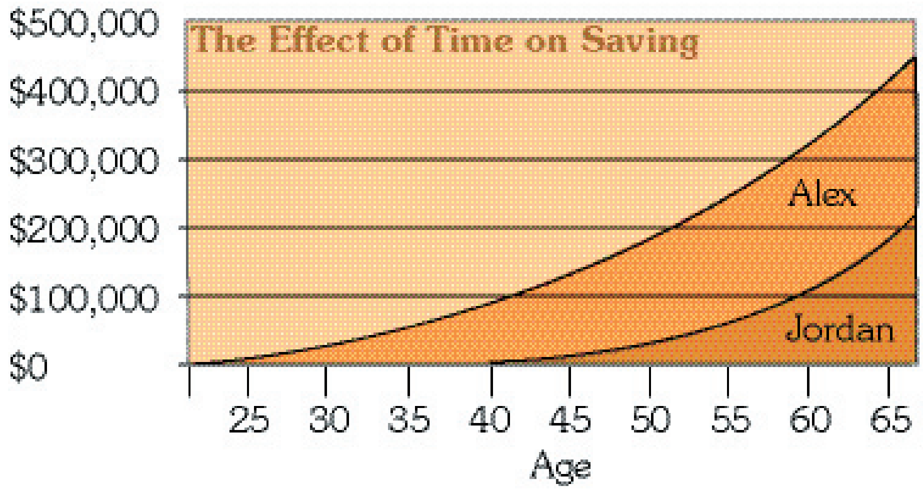
Excuse 1: I can't afford it

Nearly one in four people say they don't have money to contribute to retirement after all the bills are paid. Take another look at that Taco Bell budget. Got to live with a roommate, I'm barely making the light bill, and I've got to take the bus! It might feel like we're too far in the hole to worry about the future sometimes, but take a look at our discretionary income there: $170.38! If we can find the $25 to go out to dinner every Tuesday night, we can find $100 a month to put in a retirement account.

MAKE THIS HAPPEN. Even if you have to do it one dollar at a time over the course of the month, make it happen. Even if you have to forgo that morning cup of coffee, make it happen. And if you think putting away $25 a week won't make a difference, consider this: Contribute just $100 a month for thirty years, and if your money grows on average 8% a year, your total contributions of $36,000 will grow to almost $144,052.21 over those 30 years. When you think about it that way, skipping the regular Tuesday dinner doesn't seem so bad, does it?

Excuse 2: I'm young. There's plenty of time to save for retirement later.

This is one of the most seductive retirement lies. For a good long while, it is true that retirement is a ways off. (Even if you're fifty-five, it's still at least ten years away.) But, the longer you put off saving for retirement, the less interest you'll earn and the more difficult it will be for you to save. Remember when we talked about compounding interest? This graph deals with compound interest over time, and it means a lot for retirement savings:



Alex and Jordan both put just over $90,000 in their retirement accounts over the years, but Alex began saving ($2,000 per year) at age twenty-two, while Jordan began saving (about $3,000 per year) twenty years later at age forty-two. Even though they both put in the same total amount, Alex will have over twice as much money at retirement as Jordan will when they reach age sixty-seven (assumes a 6% annual rate of return). That's because her money had more time to grow, so it was able to make more of itself than Jordan's.

Note: This is illustrative and not reflective of guaranteed profits over time. Actual results may fluctuate based on market conditions.

This should fundamentally change how you think about money. Seriously, you have two people who put the same dollar amount into their retirement funds. The one who started twenty years later contributed the **exact same** amount, but ended up with less than half as much.

For anyone who cares about making your money work for you, this visual should speak volumes. It turns out that one of the smartest things you can do is simply to get time on your side. This is how you shortcut the hard work – by taking advantage of the power of compounding interest and the fact that you will only have an increasing number of financial obligations pulling at your purse strings as the years go by.

This is an extremely important point, so let's look at one more example. In this example, Drew and Alan both start working for the same company when they turn 18. It's a great job. The company promotes from within, and the environment is fantastic. Both Drew and Alan decide that they want to make this job their permanent career. The company offers matching funds in a 401(k) up to 5% of their salary. Alan starts immediately putting money into the 401(k). He contributes $1,000 per year, which the company matches – making his retirement investment $2,000 per year, earning an average 8% return per year. Alan contributes money for 10 years and then stops. With the company's match, Alan's total contribution over those ten years is $20,000.

Drew decides that he doesn't want to save yet. He's 18, and retirement is a long way away. He wants to live it up while the living is good. Nothing wrong with that, right? But, Alan keeps talking to him about all the things he plans to do when he retires. When he turns 28, Drew has settled down a bit and is starting to think about retirement. He finally takes Alan's advice and starts contributing to his 401(k) plan. He puts in the same amount. He contributes the full amount for the next 37 years and **never catches up**. Let's take a look at the math:

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Age	ALAN Annual Payment	ALAN Accumulated Amount	DREW Annual Payment	DREW Accumulated Amount
18	$2,000.00	$2,160.00	$0	$0
19	$2,000.00	$4,492.80	$0	$0
20	$2,000.00	$7,012.22	$0	$0
21	$2,000.00	$9,733.20	$0	$0
22	$2,000.00	$12,671.86	$0	$0
23	$2,000.00	$15,845.61	$0	$0
24	$2,000.00	$19,273.26	$0	$0
25	$2,000.00	$22,975.12	$0	$0
26	$2,000.00	$26,973.12	$0	$0
27	$2,000.00	$31,290.97	$0	$0
28	$0	$33,794.25	$2,000.00	$2,160.00
29	$0	$36,497.79	$2,000.00	$4,492.80
30	$0	$39,417.62	$2,000.00	$7,012.22
31	$0	$42,571.03	$2,000.00	$9,733.20
32	$0	$45,976.71	$2,000.00	$12,671.86
33	$0	$49,654.84	$2,000.00	$15,845.61
34	$0	$53,627.23	$2,000.00	$19,273.26
35	$0	$57,917.41	$2,000.00	$22,975.12
36	$0	$62,550.80	$2,000.00	$26,973.12
37	$0	$67,554.87	$2,000.00	$31,290.97
38	$0	$72,959.26	$2,000.00	$35,954.25
39	$0	$78,796.00	$2,000.00	$40,990.59
40	$0	$85,099.68	$2,000.00	$46,429.84
41	$0	$91,907.65	$2,000.00	$52,304.23
42	$0	$99,260.26	$2,000.00	$58,648.57
43	$0	$107,201.09	$2,000.00	$65,500.45
44	$0	$115,777.17	$2,000.00	$72,900.49
45	$0	$125,039.35	$2,000.00	$80,892.53
46	$0	$135,042.49	$2,000.00	$89,523.93
47	$0	$145,845.89	$2,000.00	$98,845.84
48	$0	$157,513.56	$2,000.00	$108,913.51
49	$0	$170,114.65	$2,000.00	$119,786.59
50	$0	$183,723.82	$2,000.00	$131,529.52
51	$0	$198,421.73	$2,000.00	$144,211.88
52	$0	$214,295.47	$2,000.00	$157,908.83
53	$0	$231,439.10	$2,000.00	$172,701.54
54	$0	$249,954.23	$2,000.00	$188,677.66
55	$0	$269,950.57	$2,000.00	$205,931.87
56	$0	$291,546.62	$2,000.00	$224,566.42
57	$0	$314,870.34	$2,000.00	$244,691.74
58	$0	$340,059.97	$2,000.00	$266,427.07
59	$0	$367,264.77	$2,000.00	$289,901.24
60	$0	$396,645.95	$2,000.00	$315,253.34
61	$0	$428,377.63	$2,000.00	$342,633.61
62	$0	$462,647.84	$2,000.00	$372,204.30
63	$0	$499,659.66	$2,000.00	$404,140.64
64	$0	$539,632.44	$2,000.00	$438,631.89
65	$0	$582,803.03	$2,000.00	$475,882.44
TOTAL	$20,000.00	**$582,803.03**	$76,000.00	**$475,882.44**

Let me say it again. Drew has the same $2,000 per year going into his retirement fund ($2,000 that Alan stopped contributing when he turned 27), but he never catches up. That's compounding interest at work. Alan puts in $20,000 and ends up with $582,803.03 when he retires. Drew puts in $76,000, but only ends up with $475,882.44. All because he waited ten years to start.

So, this is not something you can keep putting off. This doesn't mean that you're doomed to fail if you didn't start saving for retirement when you were 18. This means that the longer you wait, the more it's going to cost you to reach your goals. Saving for retirement is something to tackle today. The time to start is now.

Excuse 3: When I get married someday, I won't have to worry about money.

I bet all the married people reading this are having a good laugh right now. Marriage does not automatically make your financial life easier. The effect of marriage on your finances depends on a host of factors: Do you both work? Do you both make enough to support yourselves? If one or both of you got laid off, could you still afford your rent or mortgage? Are you honest with each other about your spending? Do you agree on your financial goals? Will you have children? If so, do you make enough that one of you can stay home with them? Bottom line: this excuse is ridiculous.

Retirement Savings Options for Stay-at-Home Parents

When you're working, your employer will often facilitate your retirement savings by taking money right out of your paycheck and putting it into savings so you don't have to think about it. But, what are you supposed to do as a stay-at-home parent?

- When you leave the workforce, roll over your 401(k) into an IRA
- Set up a spousal IRA if you file a joint return with your spouse
- Open an individual 401(k) or a SEP-IRA if you're self-employed
- Increase your spouse's 401(k) contribution

Excuse 4: What about Social Security? I'll just live off that when I retire

When Social Security was first created by the U.S. Government, the math made a lot of sense. Seven workers contributed to Social Security for every one worker withdrawing benefits. The average American was retiring at 60 and dying around 65. Today, the numbers are a little different. Today, there is approximately one worker contributing to Social Security for every three workers withdrawing benefits. It's estimated that by the year 2020 there will be *one worker* contributing to Social Security for every *five workers* withdrawing benefits. It doesn't take much math to quickly realize that the Social Security pot of gold is headed toward empty.

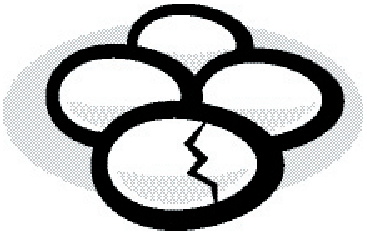
Now, Social Security is probably not going anywhere soon, meaning that you will probably still have benefits in your lifetime, but you can be certain that those benefits will be changing, and not for the better. The retirement age today is 67 (and it may be raised again), people earning above $100,000 in retirement may no longer be eligible, and the level of Social Security benefits have been reduced and may be reduced even more in the future.

Maybe today's retirees can rely on this, but the future of Social Security is uncertain. Anyone retiring in the coming years should not count on this as a be-all and end-all. If the system doesn't go bankrupt and you get to receive Social Security benefits, great. If not, what's your plan B? Is the risk of receiving nothing a chance you are willing to take?

Excuse 5: I deserve to have fun with my money today – I work hard for it

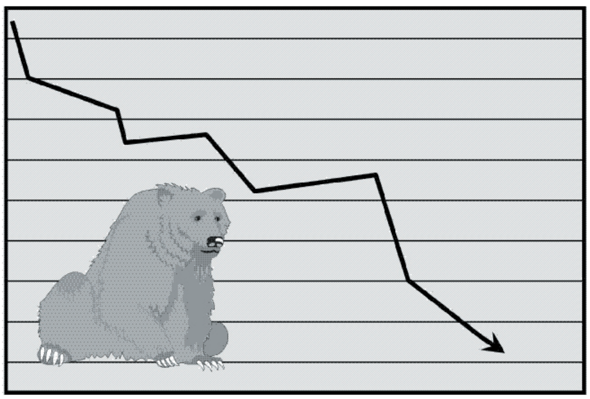
That's what Drew said. But, was Alan living off Ramen noodles and no electricity for ten years? No, all he was doing was setting aside money for retirement before setting aside some for having fun. Saving for retirement versus enjoying life now is not an either/or proposition. You can do both. Also, let me put it this way: yes, you deserve to enjoy your money now, but you also deserve not to have to count pennies when you're old and gray.

Excuse 6: An inheritance is coming my way someday. I'll be able to live off that.



This is a case of counting chickens before they hatch. You never know what could happen to that inheritance (it could be devoured by medical bills, it could dwindle away in a financial crisis, or you may need it to pay off debts or taxes of the estate). Sure, it would be nice to inherit a million bucks and be able to put it toward your retirement, but counting on doing so is not a plan; it's a gamble – at best. It's far safer to plan to fund your own retirement and then enjoy your inheritance as a bonus if you do indeed receive one.

Excuse 7: The market is down, so why bother to invest in a retirement account?

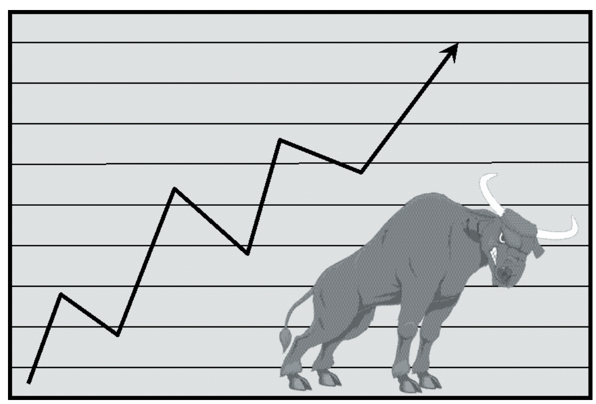


Yes, the market is unreliable from year to year, and yes, the value of your investments will dip in a down market. But, downswings don't last forever, and historically, over long periods of time, the market has shown solid returns, the S&P 500, for example, has averaged 9.28% annual returns over the last twenty-five years. This, coincidentally, is much higher than the 8% we've been using in our examples.

Alternatively, let's say you leave your money in a savings account bearing 1% interest (which is being generous): you're going to lose the purchasing power of those dollars due to inflation (which is estimated at 3%). Yes, with the market, you're opening yourself up to some risk – but with risk comes reward.

Excuse 8: I'll start saving when the market improves.

No one can predict the market. No one. So, while it's true that you cannot time your investments perfectly so that they only ever go up, history has shown that if you invest regularly over decades, your investments should experience more ups than downs. So, invest for the long haul, and don't fret over minor dips now. If you do, you'll be missing out on an opportunity to amass money later.



How much risk is too much risk?

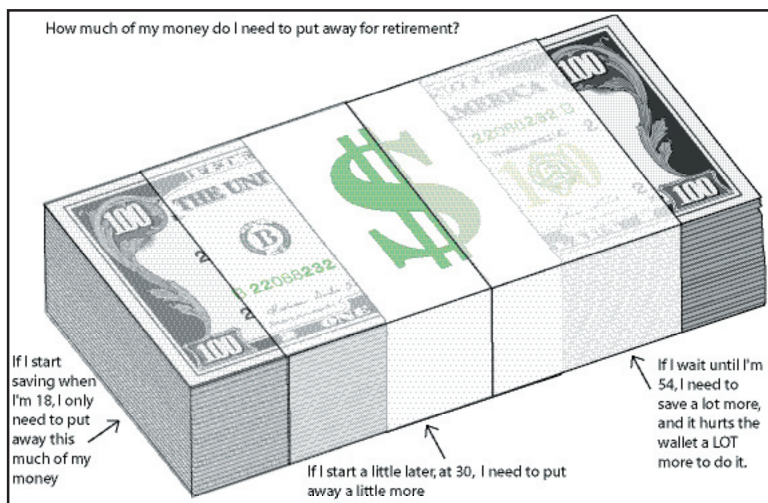
Investing comes with risk. There is no getting around that fact. There is no means of investing that doesn't carry some risk. But, some investments carry more risk than others. Savings accounts, for example, are traditionally a very safe way to "invest." Lottery tickets are about the highest risk "investment" you can make. We can see that in the possibility of return. You're pretty much guaranteed to bring in your 0.6% interest with a savings account. The chances of that not happening are very, very low. The chances of you winning the lottery are also very, very low. So, the possibility of you losing your money when you buy a lottery ticket is extremely high.

Now, neither of those are real investments. A lottery ticket is a gamble, and a savings account doesn't earn enough interest to even keep up with inflation. But, what if we're thinking about saving for retirement? The point here to understand is that the time to start is always today. If you don't start today, tomorrow will be harder. It doesn't matter if you're 18 or 30 or 54.

Markets fluctuate over time. They go up. They go down, and then they come back up – eventually. The key with risk is in knowing how much time you have and how much risk is appropriate for you. If you're 18, time is on your side. You can invest a little bit and depend on compounding interest and a market that has plenty of time to recover if it experiences a downturn. But, if you were 54 in 2006 and only just started investing, you would have experienced a market that lost over 60% of its value in one year. There simply isn't enough time to take that kind of risk.

You might think that someone who is 54 needs to take more risk because they need more money in a shorter amount of time, but they also can't afford to lose the money that they invest. Someone who starts investing so late needs a much lower risk level. Someone who is 30 years old can afford more of a mid-level risk. They don't have as much time as the 18-year-old, but they have more than the 54-year-old.

So, what should you do if you really are going to be 54 when you get out and start saving for retirement? Is it too late? Maybe you should just forget about it? NO. The best time to start investing is yesterday. The second best time is today. Tomorrow will only get harder, but never is never an option. To put it another way, it's always better to have something put away for retirement rather than nothing. If you want to know more about risk, Personal Investment Management is an excellent class that will give you much more information. The important thing to remember is to select the options appropriate to your financial situation and to your attitude toward risk. No matter what you choose, there will always be certain restrictions, pros and cons. For example, when you invest in 401(k)'s or IRA's, investment in collectibles such as gems, stamps, or coins is prohibited. Gold coins typically hold a decent return on investment, but they are not included in trustee funds.



Excuse 9: I'll be able to use the equity in my home to retire.

Sure, selling your home will free up lots of cash… but then where will you live? And, what if the market is down when you want to sell that home? Remember the housing crisis a few years ago? The one where tens of thousands of near retirees were left without nest eggs after the values of their homes plummeted? This is not the smartest game plan.

Excuse 10: I need to get my kids through college first, and then I can focus on my retirement.

Yes, college is a big expense, and you should definitely save for it – that is, once your own retirement needs are taken care of. If you're a parent, it's a natural instinct to put your children's futures before your own. But, think about it this way: if you don't save the full amount for your children's college education, you can always fall back on financial aid, grants, scholarships, and student loans to help pay your children's way. When it comes to your retirement, however, there are no loans. Let me repeat: *there are no loans.* All you'll have to live on is what you've saved. For that reason, saving for retirement should be your top financial priority – always.

Obviously, you don't want to saddle your kids or your future kids with loans – what parent would? But remember that if you pay for your children's college and then cannot afford your retirement, you will end up burdening your children all the same. They will feel obligated to help you out – at a time when their own families need them financially.

Excuse 11: I plan to keep working even during retirement.

You may love your work, and it may be the kind of work you can even imagine yourself doing well into your seventies or eighties. But, while that's easy to say now, what if you can't find work at that point in your life, or what if you have health problems or family obligations that prevent you from working? While there is nothing wrong with hoping for a best-case scenario, it isn't wise to plan around one. Sock away some money now so you're ready for whatever may come your way. The last thing you should have to deal with is a health issue and money concerns at the same time.

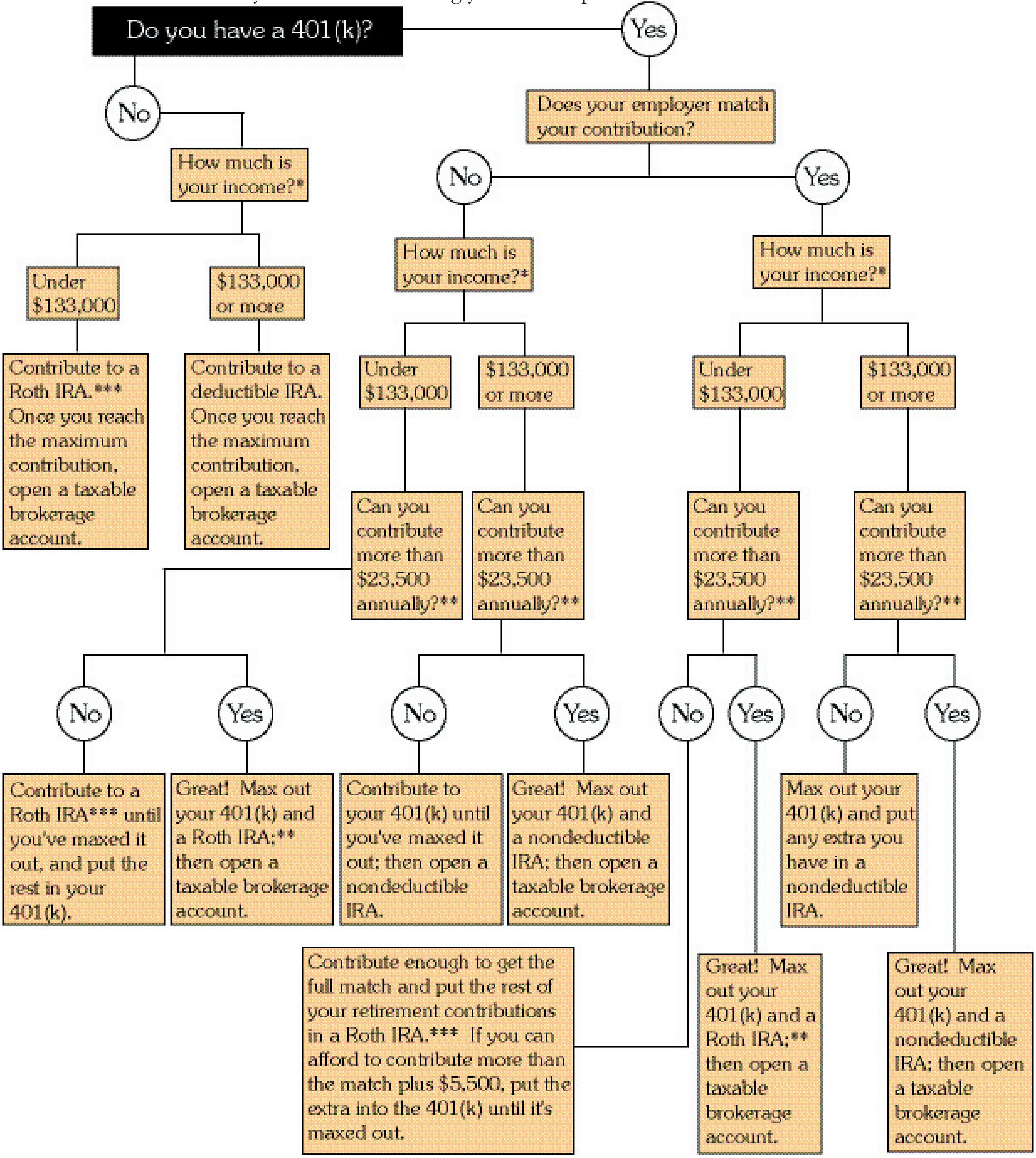
Which retirement plans work best for you?

Let's look at the major retirement savings options available, all in one place.

Type of Account	Description	Taxes on Contributions?	Taxes on Withdrawals?
401(k)	An employer-sponsored account into which you can save pretax money from every paycheck. In retirement, the money you withdraw - including earnings - will be taxed in whatever income bracket you're in at the time.	No	Yes
Roth 401(k)	An employer-sponsored account into which you can save after-tax money from every paycheck. In retirement, the money you withdraw - including earnings - is entirely tax free.	Yes	No
Traditional IRA	An individual retirement account into which you can save money and receive a tax deduction if you meet certain tax income requirements or if you don't have n employer-sponsored retirement plan - such as a 401(k) - available to you.	No	Yes
Roth IRA	An employer-sponsored account into which you can save after-tax money if youo meet certain income requirements. In retirement, the money you withdraw - both your deposits and all of your earning - is entirely tax free.	Yes	No

Each of these account types is essentially the jar you'll put your investmentment money in. Which jar should you use? Everyone's retirement situation is unique, so it's a great idea to talk to a retirement expert about your particular circumstances. If you want a head start, try the flow charts on the next pages:

Are you unmarried or filing your taxes separately? Use this chart:



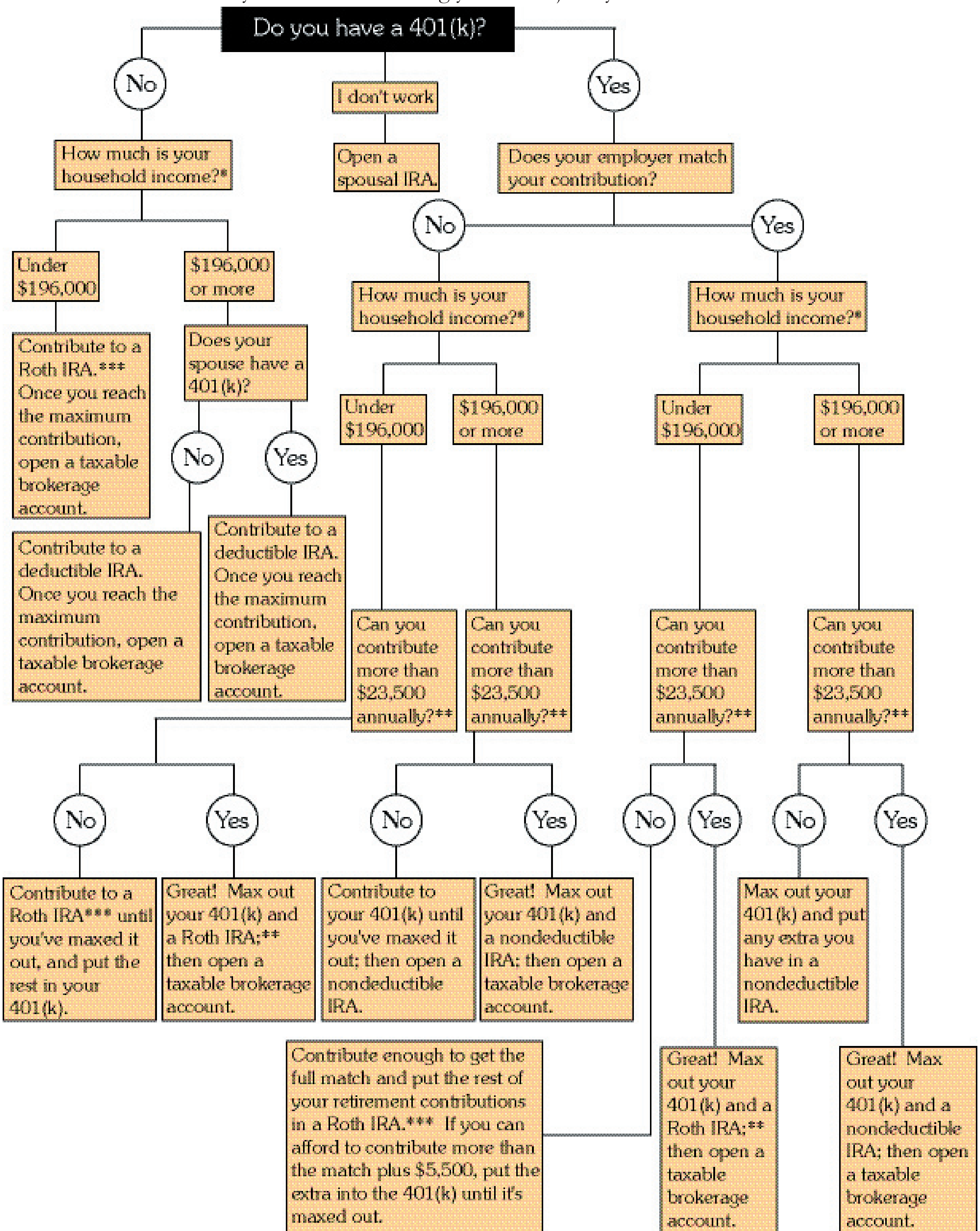
*Income refers to your modified adjusted gross income. This convoluted name reflects the convoluted way in which it is calculated. First, you subtract various items, such as education expenses or IRA contributions, from your income to determine your adjusted gross income (which is used for tax purposes). Then you add back in other items, such ass student-loan deductions and foreign income, to get your modified adjusted gross income.

**$23,000 is the combined 401(k) [$18,000] and IRA [$5,500] contribution limit as of 2017. These can change every year.

***The rules for eligibility and contribution limits for a Roth IRA change every year. In 2017, if your modified adjusted gross income was less than $118,000, you could contribute the maximium amount, which was $5,500 (or $6,500 if you were fifty or older). If your modified adjusted gross income was between $118,000 and $132,000, you were eligible to make a partial contribution.

130

Are you married and filing your taxes jointly? Use this chart:



*Income refers to your modified adjusted gross income. This convoluted name reflects the convoluted way in which it is calculated. First, you subtract various items, such as education expenses or IRA contributions, from your income to determine your adjusted gross income (which is used for tax purposes). Then you add back in other items, such ass student-loan deductions and foreign income, to get your modified adjusted gross income.

**$23,500 is the combined 401(k) [$18,000] and IRA [$5,500] contribution limit as of 2017. These can change every year.

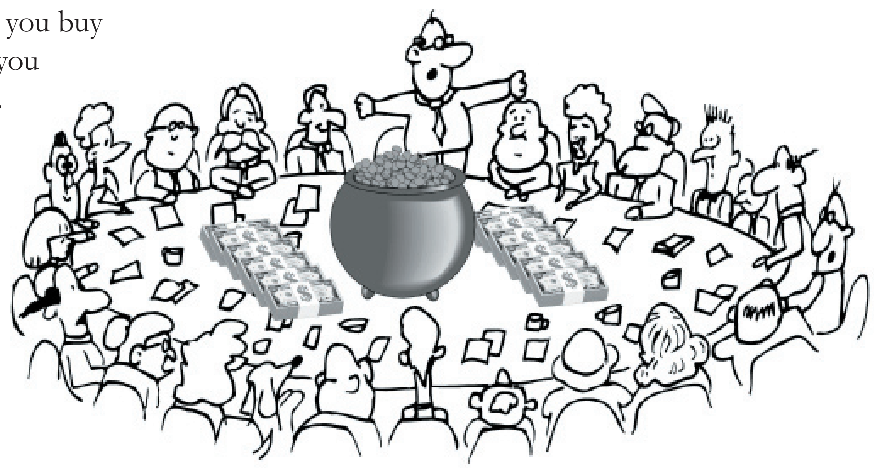
***The rules for eligibility and contribution limits for a Roth IRA change every year. In 2017, if your modified adjusted gross income was less than $186,000, you could contribute the maximium amount, which was $5,500 (or $6,500 if you were fifty or older). If your modified adjusted gross income was between $186,000 and $196,000, you were eligible to make a partial contribution.

Money Saver! You should invest the maximum allowable amount in your 401(k) or ROTH 401(k). You should do this before you consider any other taxed investment alternatives. Only after you have maxed out on your 401(k) contributions should you consider other investments

Are there any other options?

Yes. In the flow charts on the previous pages we mentioned opening a brokerage account. This is more like traditional investing, and is best dealt with in Personal Investment Management. But, it does include other retirement options such as mutual funds.

A mutual fund is a company that pools money from many investors and invests the money in stocks, bonds, short-term money-market instruments, other securities or assets, or some combination of these investments. The combined holdings that the mutual fund owns are known as its 'portfolio.' Each share of a mutual fund that you buy represents how much of the fund's holdings you own and the income those holdings generate.



Some advantages of mutual funds are diversification (which lowers your risk level by spreading out your investment), professional management (mutual fund managers are very good at what they do because that is all they do), and liquidity (meaning you don't have to wait until you're 59½ to start withdrawing your money. There are some disadvantages to mutual funds as well. There is usually a minimum investment amount to participate in a mutual fund (and it can be quite high). That professional management also usually comes with a much higher commission cost than with other types of retirement funds. Mutual funds have liquidity, but you are limited to withdrawing funds the next day (meaning you can't immediately sell a stock if it starts to dip. You have to wait until after the market closes).

Mutual Funds can return a high percentage of your investment, but there are no tax incentives for using them. They can be a great addition to your retirement portfolio, but they should not replace the more traditional options.

Whatever options you choose to reach your retirement goal, a simple savings account is not going to cut it. You'll need a comprehensive investing strategy. Not only do you want to maximize each and every dollar, but you'll also need to account for inflation. Left under your mattress, your dollar's spending power will slowly but surely diminish over time. Over the long term, inflation has averages about 3% per year, which means that if you put $1,000 in a shoe box in your closet today and let it sit for forty years, you'll still have $1,000 – but it will only be worth about $306 in today's dollars. It also means that you need to invest in an option that will return at least 3% in order to hold onto your purchasing power.

Instead, if you invest that $1,000 and earn 5% a year for forty years, you could end up with $7,040, or about $2,158 in today's dollars. Your buying power went up. Considering that we all want to live a long life, you'll need to maximize your dollars for the long run.

Money Saver! *Never* take money out of a retirement account (until you're ready to retire). You'll be taxed and penalized like crazy. Get another job, borrow from a family member, and exhaust all other options before you even think about withdrawing from retirement savings. Enough said.

REEFS

Conclusion

You have reached the end of the Personal Financial Management class, but, at the same time, arrived at the beginning of your opportunities. Before you leave this class, let's quickly review what you have learned.

The first foundational block that must be put in place to successfully manage your money is the discipline of budgeting. Until you understand how much money you have to spend and control how you spend it, you are not in the driver's seat financially. If you want to be successful with your money, you will need to adopt a budgeting plan. Management of your money also entails knowing your success. By completing a net worth statement at least every six months, ideally, every three months you will gain an idea of how you are managing your money. In learning to use basic banking tools successfully you will be able to keep your money safe and allow it to grow. Building a relationship with a bank or a credit union is essential if you want to take the next step towards wealth. Building credit-worthiness and eliminating debt will help you gain the financial independence you desire and allow you to gain larger assets. Understanding the basics of buying an automobile and a home empower you to reach two large financial goals in your pursuit toward financial health. Protecting your assets with insurance provides a safety net for the progress you have made and allows you to have peace of mind. Finally you have learned how to prepare for the "Golden Years" of retirement, allowing yourself to have a peace of mind that extends beyond your working days.

Remember that although you leave the classroom, the learning process should still be happening. Take time to re-read this material, find other sources about financial management and study. The key to becoming financially healthy is applying what you learned and gaining more knowledge about the subject of finance. If you are interested in making your money grow and generate wealth, the next step would be to take the Personal Investment Management (PIM) class.

The PIM class was designed to offer you a working knowledge of investment products. At the conclusion of PIM you should be familiar with the following types of investment products: common stocks, preferred stocks, government, corporate, and municipal bonds, mutual funds, ETFs, REITs, and SPDRs. PIM is focused on making your money earn money for you, and building wealth.

Whatever you do going forward, remember that the best time to start is yesterday. Today is second best. The absolute worst time to start building toward a better financial future is tomorrow. Don't just set a goal. Reach for it. Don't just hope for the best future. Work toward it. *Today.*

Budget Worksheet

Monthly Income (after taxes)

Income/salary from all sources	
Investment income	
Dividends, interest, capital gains	
Other income	
Total monthly income	

Monthly Savings

General	
Emergency/rainy day fund	
College/other education	
Retirement	
Other (i.e., house down payment)	
Total monthly savings	

Monthly Expenses

Home

Mortgage/rent/HOA	
Housecleaning/landscaping	
Electricity/Gas	
Water/Trash/Recycling	
Home phone	
Mobile phone	
Cable/Internet access	
Security	
Total home	

Personal

New clothes	
Dry cleaning/laundry	
Barbershop/salon	
Hobbies	
Charitable donations (cash)	
Child care	
Pets	
Total personal	

Food

Groceries	
Dining/take out	
Total food	

Auto/transportation

Car loan/lease	
Car insurance	
Maintenance	
Public transit	
Parking	
Gasoline	
Total auto/transportation	

Debt category

Credit cards	
Other loans/lines	
Total other	

Health

Toiletries	
Cosmetics	
Pharmacy	
Health Club	
Medical/dental	
Total health	

Entertainment/recreation

Movies/shows	
Vacation	
Parties/gifts	
Subscriptions	
Memberships (art,music)	
Total entertainment and recreation	

Education

Tuition	
Books	
Student loans	
Total education	

Total monthly expenses	

Add up all total expense areas in grey.

Total monthly income	
- Total monthly expenses	
= Net cash flow	

Quick Budget Tips

To make your monthly income last, consider using it in the following sequence:

- Pay your monthly bills. There are many potential penalties if you pay late, such as late fees, losing possession of things you've bought on credit, even being evicted from an apartment.
- Set aside the money you'll need for your weekly and day-to-day expenses, like groceries and bus fare.
- Put money into savings. Try to build two months of take-home pay for an unexpected financial emergency.
- Set aside money for larger expenses you know are coming, such as car repairs or appliances.
- Set aside money for future goals whether it's a home, college for your children, a new car, or travel.

If possible, try to stretch your bills out evenly over the month, so that you pay the same amount each week. For regular monthly bills, you may be able to request a change of a bill's due date to spread out your bills evenly. Try to avoid having one week when all of your cash-on-hand is needed for bills.

For large expenses that are not monthly (for example, insurance bills, car repairs, holiday gifts, etc.) place an amount of money aside each week or pay period so that you have money to pay the bills when they are due.

Here are some guidelines to consider for how much of your take-home monthly income you might budget for various expenses:

- Housing (rent or mortgage): 20 to 35%
- Utilities (gas, electric, water, trash, telephone): 4 to 7%
- Food (at home and away): 15 to 30%
- Family necessities (laundry, toiletries, hair care): 2 to 4%
- Medical (insurance, prescriptions, bills): 2 to 8%
- Clothing: 3 to 10%
- Transportation (car payment, gas, insurance, repairs, or bus fare): 6 to 30%
- Entertainment: 2 to 6%
- Savings: 10 to 15%

Try to limit your installment debts (car loand, credit card bils, other loans) to 10 - 20% of your monthly budget.

To decide whether a purchase is necessary, ask yourself these three questions:

- Do I really need it?
- Do I really need it today? What would happen if I don't buy it now?
- Can I spend less to meet this need?

Always review your bank and credit card statement. It will remind you where your money is going.

Net Worth Statement

Item/Description	Value	-	Debt	=	Equity
Real Estate					
Real Estate					
Car					
Car					
Cash on Hand					
Checking Account #1					
Checking Account #2					
Savings Account					
Money Market Account					
Mutual Fund					
Mutual Fund					
IRA					
ROTH IRA					
401(k)					
Insurance Cash Value					
Household items					
Jewelry					
Antiques					
Boat					
Unsecured Debt (negative)					
Credit Card Debt (negative)					
Other					
Other					
Other					
Total (Value – Debt = Equity):		-		=	

Residential Lease for Apartment or Unit in Multi-Family Rental Housing (other than a Duplex) Including a Mobile Home, Condominium, or Cooperative

INSTRUCTIONS:

1. Licensee: Give this disclosure to the Landlord prior to your assisting with the completion of the attached Lease.
2. Licensee: As the person assisting with the completion of the attached form, insert your name in the first (5) blank "Name" spaces below.
3. Licensee: **SIGN** the disclosure below
4. Landlord/Owner and Tenant: Check the applicable provision regarding English contained in the disclosure and **SIGN** below.
5. Licensee: Retain a copy for your files for at least 6 years. Landlord/Owner and Tenant: Retain a copy for your files. This disclosure does not act as or constitute a waiver, disclaimer or limitation of liability.

THIS FORM WAS COMPLETED WITH THE ASSISTANCE OF:

______________________________ Licensee Name

______________________________ Name of Brokerage/Business

______________________________ Address

______________________________ Phone Number

DISCLOSURE:

______________________________ (Name) told me that he/she is a non-lawyer and may not give legal advice, cannot tell me what my rights are or remedies are, cannot tell me how to testify in court, and cannot represent me in court.

Rule 10-2.1(b) of the Rules Regulating the Florida Bar defines a paralegal as a person who works under the supervision of a member of the Florida Bar and who performs specifically delegated substantive legal work for which a member of the Florida Bar is responsible. Only persons who meet the definition may call themselves paralegals.

______________________________ (Name) informed me that he/she is not a paralegal as defined by the rule and cannot call himself/herself a paralegal.

______________________________ (Name) told me that he/she may only help my type the factual information provided by me in writing into the blanks on the form.

______________________________ (Name) may not help me fill in the form and may not complete the form for me.

If using a form approved by the Supreme Court of Florida, ______________________________ (Name) may ask me factual questions to fill in the blanks on the form and may also tell me how to file the form.

Landlord/Owner:

_______ I can read English.

_______ I cannot read English, but this notice was read to me by

Tenant:

______ I can read English

______ I cannot read English but this notice was read to me by

______________________________ (Name) in ______________________________ (Language) which I understand.

______________________________ (Licensee Signature)

______________________________ (Landlord Signature)

______________________________ (Tenant Signature)

Residential Lease for Apartment or Unit in Multi-Family Rental Housing (other than a Duplex) Including a Mobile Home, Condominium, or Cooperative

(FOR A TERM NOT TO EXCEED ONE YEAR)

(Not to be used for Commercial, Agricultural, or other Residential Property)

WARNING: IT IS VERY IMPORTANT TO READ THE ENTIRE LEASE CAREFULLY. THE LEASE IMPOSES IMPORTANT LEGAL OBLIGATIONS.

AN ASTERISK (*) OR A BLANK SPACE (_______) INDICATES A PROVISION WHERE A CHOICE OR A DECISION MUST BE MADE BY THE PARTIES.

NO CHANGES OR ADDITIONS TO THIS FORM MAY BE MADE UNLESS A LAWYER IS CONSULTED.

I. TERMS AND PARTIES. This is a lease ("the Lease") for a period of ____________ months (the "Lease Term"), beginning
(number)
____ and ending ____, between
(month, day, year) (month, day, year)

____ and ____
(name of owner or the property) (name(s) of person(s) to whom the property is leased)

(In the Lease, the owner, whether one or more, of the property is called "Landlord." All persons to whom the property is lease are called "Tenant".)

Landlord's E-mail Address ____
Landlord's Telephone Number ____
Tenant's E-mail Address ____
Tenant's Telephone Number ____

II. PROPERTY RENTED: Landlord leases to Tenant apartment or unit number _______ in the building located at ____________
____ known as
(street address)
____ , ___________________ ,
(name of apartment or condominium) (city)
Florida _________________, together with the following furniture and appliances:
(zip code)
____
____
____

[List all furniture and appliances. If none, write "none".] (In the Lease, the property leased, including furniture and appliances, if nay, is called the "Premises".)

III. COMMON AREAS. Landlord grant to Tenant permission to use, during the Lease Term, along with others, the common areas of the building and the development of which the Premises are a part.

IV. RENT PAYMENTS AND CHARGES. Tenant shall pay rent for the Premises in installments of $________________ each on the _______________ day of each _______________________ [month, week] (a "Rental Installment Period," as used in the Lease, shall be a month if rent is paid monthly, and a week if rent is paid weekly."

Tenant shall pay with each rent payment all taxes imposed on the rent by taxing authorities. The amount of taxes payable on the beginning date of the Lease is $_________ for each installment. The amount of each installment of rent plus taxes ("the Lease Payment"), as of the date the Lease begins, is $____________. Landlord will notify Tenant if the amount of the tax changes. Tenant shall pay the rent and all other charges required to be paid under the Lease by cash, valid check, or money order. Landlord may appoint an agent to collect the Lease Payment and to perform Landlord's obligations.

Landlord (___) (___) and Tenant (___) (___) acknowledge receipt of a copy of this page which is page 1 of 7.

Unless this box [ ] is checked, the Lease Payments must be paid in advance beginning ______________________________________.
(date)

If the tenancy starts on a day other than the first of the month or week as designated above, the rent shall be prorated from ____________________ ______ through ______________________ in the amount of $__________________ and shall be due on
(date) (date)

_________________________. (If rent paid monthly, prorate on a 30-day month.)
(date)

V. DEPOSITS, ADVANCE RENT, AND LATE CHARGES. In addition to the Lease Payments described above, Tenant shall pay the following: (check only those items that apply)

_____ a security deposit of $___________ to be paid upon signing the Lease.
_____ advance rent in the amount of $__________ for the Rental Installment periods of ____________________________ to be paid upon signing the Lease.
_____ a pet deposit in the amount of $__________ to be paid upon signing the Lease.
_____ a late charge in the amount of $__________ for each Lease Payment made more than _____ days after the date it is due.
_____ a bad check fee in the amount of $__________ (not to exceed $20.00 or 5% of the Lease Payment, whichever is greater) if the Tenant makes any Lease Payment with a bad check. If Tenant makes any Lease Payment with a bad check, Landlord can require Tenant to pay all future Lease Payments in cash or by money order.
_____ Other: ____
_____ Other: ____

VI. SECURITY DEPOSTS AND ADVANCE RENT. If Tenant has paid a security deposit or advance rent the following provisions apply:

A. Landlord shall hold the money in a separate interest-bearing or non-interest-bearing account in a Florida banking institution for the benefit of the Tenant. If Landlord deposits the money in an interest-bearing account, Landlord must pay Tenant interest of at least 75% of the annualized average interest paid by the bank or 5% per year simple interest, whichever Landlord chooses. Landlord cannot mix such money with any other funds of Landlord or pledge, mortgage, or make any other use of such money until the money is actually due to the Landlord; or

B. Landlord must post a surety bond in the manner allowed by law. If Landlord posts the bond, Landlord shall pay Tenant 5% interest per year.

At the end of the Lease, Landlord will pay Tenant, or credit against rent, the interest due to Tenant. No interest will be due in Tenant wrongfully terminates the Lease before the end of the Lease Term.

If Landlord rents 5 or more dwelling units, then within 30 days of Tenant's payment of the advance rent or any security deposit, Landlord must notify Tenant in writing of the manner in which Landlord is holding such money, the interest rate, if any, that Tenant will receive, and when such payments will be made.

VI. NOTICES. ____ is Landlord's Agent. All notices to Landlord and all
(name)

Lease Payments must be sent to Landlord's Agent at ____
(address)

Unless Landlord gives Tenant written notice of a change. Landlord's Agent may perform inspections on behalf of Landlord, subject to Article XII below. All notices to Landlord shall be given by certified mail, return receipt requested, or by hand delivery to Landlord or Landlord's Agent.

Any notice to Tenant shall be given by certified mail, return receipt requested, or delivered to Tenant at the Premises. If Tenant is absent from the Premises, a notice to Tenant may be given by leaving a copy of the notice at the Premises.

VII. USE OF PREMISES. Tenant shall use the Premises only for residential purposes. Tenant also shall obey, and require anyone on the Premises to obey, all laws and any restrictions that apply to the Premises. Landlord will give Tenant notice of any restrictions that apply to the Premises.

If the Premises are located in a condominium or cooperative development, the Lease and Tenant's rights under it, including as to the common areas, are subject to all terms of the governing documents for the project, including, without limitation, any Declaration of Condominium or proprietary lease, and any restrictions, rules, and regulations now existing or hereafter adopted, amended, or repealed.

Landlord (___) (___) and Tenant (___) (___) acknowledge receipt of a copy of this page which is page 2 of 7.

Unless this box [ ] is checked, Landlord may adopt, modify, or repeal rules and regulations for the use of common areas and conduct on the Premises during the Lease Term. All rules and regulations must be reasonable and in the best interest of the development in which the Premises are located.

Occasional overnight guests are permitted. An occasional overnight guest is one who does not stay more than _______ nights in any calendar-month (If left blank, 7). Landlord's written approval is required to allow anyone else to occupy the Premises.

Unless this box [ ] is checked or a pet deposit has been paid, Tenant may not keep or allow pets or animals on the Premises without Landlord's approval of the pet or animal in writing.

Unless this box [ ] is checked, no smoking is permitted in the Premises.

Tenant shall not create any environmental hazards on or about the Premises.

Tenant shall not destroy, deface, damage, impair, or remove any part of the Premises belonging to the Landlord, not permit any person to do so.

Tenant may not make any alterations or improvements to the Premises without first obtaining Landlord's written consent to the alteration or improvement. However, unless this box is checked [ ] Tenant may hang pictures and install window treatments in the Premises without Landlord's consent, provided Tenant removes all such items before the end of the Lease Term and repairs all damage resulting from the removal.

Tenant must act, and require all other persons on the Premises to act, in a manner that does not unreasonably disturb any neighbors or constitute a breach of the peace.

VIII. MAINTENANCE. Landlord and Tenant agree that the maintenance of the Premises must be performed by the person indicated below:

A. Landlord's Required Maintenance. Landlord will comply with applicable building, housing, and health codes relating to the Premises. If there are no applicable building, housing, or health codes, Landlord shall maintain and repair the roofs, porches, windows, exterior walls, screens, foundations, floors, structural components, and steps, and keep the plumbing in reasonable working order. If the Premises are located in a condominium, Landlord and Tenant acknowledge that the maintenance of the structural elements and common areas is performed by the condominium association as part of the common area maintenance. Landlord shall assure that the association complies with applicable building, housing, and health codes relating to the Premises. If there are no applicable building, housing, or health codes, Landlord shall assure that the association maintains and repairs roofs, porches, windows, exterior walls, screens, foundations, floors, structural components, and steps, and keeps the plumbing in reasonable working order. Landlord will be responsible for the maintenance of any items listed above for which the association is not responsible.

B. Elective Maintenance. Fill in each blank space in this section with Landlord or Tenant to show who will take care of the item noted. If a space is left blank, Landlord will be required to take care of that item (or assure that the association takes care of the items if the Premises are located in a condominium.)

_______ Smoke Detectors
_______ Extermination of rats, mice, rodents, ants, wood-destroying organisms, and bedbugs
_______ Locks and keys
_______ Clean and safe condition of outside areas
_______ Garbage removal and outside garbage receptacles
_______ Running water
_______ Hot water
_______ Lawn
_______ Heat
_______ Air conditioning
_______ Furniture
_______ Appliances
_______ Fixtures
_______ Pool (including filters, machinery, and equipment)
_______ Heating and air conditioning filters
_______ Other: ____

Tenant's responsibility, if any, indicated above, shall not include major maintenance or major replacement of equipment.

Landlord shall be responsible for major maintenance or major replacement of equipment, except for equipment for which Tenant has accepted responsibility for major maintenance or major replacement in the previous paragraph.

Major maintenance or major replacement means a repair or replacement that costs more than $___________.

Tenant shall be required to vacate the Premises on 7 days' written notice, if necessary, for extermination pursuant to this subparagraph. When vacation of the Premises is required for extermination, Landlord shall not be liable for damages, but shall abate the rent.

Nothing in this section makes Landlord responsible for any condition created or caused by the negligent or wrongful act or omission of Tenant, any member of Tenant's family, or any other person on the Premises with Tenant's consent.

C. Tenant's Required Maintenance. At all times during the Lease Term, Tenant shall:
   1. comply with all obligation imposed upon tenants by applicable provisions of building, housing, and health codes;
   2. keep the Premises clean and sanitary;
   3. remove all garbage from the dwelling unit in a clean and sanitary manner;
   4. keep all plumbing fixtures in the dwelling unit clean, sanitary, and in repair; and
   5. use and operate in a reasonable manner all electrical, plumbing, sanitary, heating, ventilating, air conditioning, and other facilities and appliances, including elevators.

X. UTILITIES Tenant shall pay all charges for hook-up, connection, and deposit for providing all utilities and utility services to the Premises during the Lease Term except ____ ______________ , which the Landlord agrees to provide at Landlord's expense. (Specify any utilities to be provided and paid for by Landlord such as water, sewer, oil, gas, electricity, telephone, garbage removal, etc.).

XI. SERVICE MEMBER. If Tenant is a member of the United States Armed Forces on active duty or state active duty or a member of the Florida National Guard or United States Reserve Forces, the Tenant has rights to terminate the Lease as provided in Section 83.682, Florida Statutes, the provisions of which can be found in the attachment to this Lease.

XII. LANDLORD'S ACCESS TO PREMISES. Landlord or Landlord's Agent may enter the Premises in the following circumstances:

A. At any time for the protection or preservation of the Premises.
B. After reasonable notice to Tenant at reasonable times for the purpose of repairing the Premises.
C. To inspect the Premises; make necessary or agreed-upon repairs, decorations, alterations, or improvements; supply agreed services; or exhibit the Premises to prospective or actual purchasers, mortgagees, tenants, workers, or contractors under any of the following circumstances:
   1. with Tenant's consent;
   2. in case of emergency;
   3. when Tenant unreasonably withholds consent; or
   4. if Tenant is absent from the Premises for a period of at least one-half a Rental Installment Period. (If the rent is current and Tenant notifies Landlord of an intended absence, then Landlord may enter only with Tenant's consent or for the protection or preservation of the Premises.)

XIII. PROHIBITED ACTS BY LANDLORD. Landlord is prohibited from taking certain actions as described in Section 83.67, Florida Statutes, the provisions of which can be found in the attachment to this Lease.

XIV. CASUALTY DAMAGE. If the Premises are damaged or destroyed other than by wrongful or negligent acts of Tenant or persons on the Premises with Tenant's consent, so that the use of the Premises is substantially impaired, Tenant may terminate the Lease within 30 days after the damage or destruction and Tenant will immediately vacate the Premises. If Tenant vacates, Tenant is not liable for rent that would have been due after the date of termination. Tenant may vacate the part of the Premises rendered unusable by the damage or destruction, in which case Tenant's liability for rent shall be reduced by the fair rental value of the part of the Premises that was damaged or destroyed.

XV. DEFAULT/REMEDIES. Should a party to the Lease fail to fulfill their responsibilities under the Lease or need to determine whether there has been a default of the Lease, refer to Part II, Chapter 83, entitled Florida Residential Landlord and Tenant Act which contains information on defaults and remedies. A copy of the current version of this Act is attached to the Lease.

XVI. ASSIGNMENT AND SUBLEASING. Unless this box [ ] is checked, Tenant may not assign the Lease or sublease all or any part of the Premises without first obtaining Landlord's written approval and consent to the assignment or sublease.

XVII. RISK OF LOSS. Subject to the next sentence, Landlord shall not be liable for any loss by reason of damage, theft, or otherwise to the contents, belongings and personal effects of the Tenant, or Tenant's family, agents, employees, guests, or visitors located in or about the Premises, or for damage or injury to Tenant or Tenant's family, agents, employees, guests or visitors. Nothing contained in this provision shall relieve Landlord or Tenant from responsibility for loss, damage, or injury caused by its own negligence or willful conduct.

XVIII. SUBORDINATION. This lease is automatically subordinate to the lien of any mortgage encumbering the fee title to the Premises from time to time.

XIX. LIENS. The interest of the Landlord shall not be subject to liens for improvements by the Tenant as provided in Section 713.10, Florida Statutes. Tenant shall notify all parties performing work on the Premises at Tenant's request that the Lease does not allow any liens to attach to the Landlord's interest.

XX. APPROVAL CONTINGENCY. If applicable, the Lease is conditioned upon approval of Tenant by the association that governs the Premises. Any application fee required by an association shall by paid by [ ] Landlord [ ] Tenant. If such approval is not obtained prior to commencement of Lease Term, either party may terminate the Lease by written notice to the other given at any time prior to approval by the association, and if the Lease is terminated, Tenant shall receive return of deposits specified in Article V, if made. IF the Lease is not terminated, rent shall abate until the approval is obtained from the association. Tenant agrees to use due diligence in applying for association approval and to comply with the requirements for obtaining approval. [ ] Landlord [ ] Tenant shall pay the security deposit required by the association, if applicable.

XXI. RENEWAL/EXTENSION. The Lease can be renewed or extended only by a written agreement signed by both Landlord and Tenant, but in no event may the total Lease Term exceed one year. A new lease is required for each year.

XXII. LEAD-BASED PAINT. [ ] Check and complete if the dwelling was built before January 1, 1978. **Lead Warning Statement** (when used in this article, the term Lessor refers to Landlord and the term Lessee refers to Tenant) Housing built before 1978 may contain lead-based paint. Lead from paint, paint chips, and dust can pose health hazards if not managed properly. Lead exposure is especially harmful to young hcildren and pregnant women. Before renting pre-1978 housing. Lessors must disclose the presence of known lead-based paint and/or lead-based paint hazards in the dwelling. Lesseess must also receiv a federally approved pamphlet on lead poisoning prevention.

Lessor's Disclosure (Initial)

____________(a) Presence of lead-based paint or lead-based paint hazards (check (i) or (ii) below):

(i) ______ Known lead-based paint and/or lead-based paint hazards are present in the housing (explain)

____

____

(ii)______Lessor has no knowledge of lead-based paint and/or lead-based paint hazards in the housing.

(b) Records and reports available to the Lessor (check (i) or (ii) below):

(i)______Lessor has provided the Lessee with all available records and reports pertaining to lead-based paint and/or lead-based paint hazards in the housing (List documents below).

____

____

(ii) Lessor has no reports or records pertaining to lead-based paints and/or lead-based paint hazards in the housing.

Lessee's Acknowledgment (initial)

(c)__________________Lessee has received copies of all information listed above.

(d)__________Lessee has receive the pamphlet **Protect Your Family From Lead in Your Home.**

Agent's Acknowledgment (initial)

(e)_________Agent has informed the Lessor of the Lessor's obligations under 42 U.S.C. 4852d and is aware of his/her responsibility to ensure compliance.

Certification of Accuracy

The following parties have reviewed the information above and certify, to the best of their knowledge, that the information provided by the signatory is true and accurate.

Lessor's signature	Date	Lessee's signature	Date
Lessor's signature	Date	Lessee's signature	Date
Agent's signature	Date	Agent's signature	Date

XXIII. ATTORNEY'S FEES. In any lawsuit brought to enforce the Lease or under applicable law, the party in whose favor a judgment or decree has been rendered may recover reasonable court costs, including attorney's fees, from the non-prevailing party.

XXIV. MISCELLANEOUS.

A. Time is of the essence of the performance of each party's obligations under the Lease.

B. The Lease shall be binding upon and for the benefit of the heirs, personal representatives, successors, and permitted assigns of Landlord and Tenant, subject to the requirements specifically mentioned in the Lease. Whenever used, the singular number shall include the plural or singular and the use of any gender shall include all appropriate genders.

C. The agreements contained in the Lease set forth the complete understanding of the parties and may not be changed or terminated orally.

D. No agreement to accept surrender of the Premises from Tenant will be valid unless in writing and signed by the Landlord.

E. All questions concerning the meaning, execution, construction, effect, validity, and enforcement of the Lease shall be determined pursuant to the Laws of Florida.

F. The place for filing any suits or other proceedings with respect to the Lease shall be the county in which the Premises is located.

G. Landlord and Tenant will use good faith in performing their obligations under the Lease.

H. As required by law, Landlord makes the following disclosure: "RADON GAS". Radon is a naturally occurring radioactive gas that, when it has accumulated in a building in sufficient quantities, may present health risks to person who are exposed to it over time. Levels of radon that exceed federal and state guidelines have been found in buildings in Florida. Additional information regarding radon and radon testing may be obtained from your county health department.

XXV. TENANT'S PERSONAL PROPERTY. TENANT MUST INITIAL THIS BOX [   ] FOR THE FOLLOWING PROVISION TO APPLY. BY SIGNING THIS RENTAL AGREEMENT, THE TENANT AGREES THAT UPON SURRENDER, ABANDONMENT, OR RECOVERY OF POSSESSION OF THE DWELLING UNIT DUE TO THE DEATH OF THE LAST REMAINING TENANT, AS PROVIDED BY CHAPTER 83, FLORIDA STATUTES, THE LANDLORD SHALL NOT BE LIABLE OR RESPONSBILE FOR STORAGE OR DISPOSITION OF THE TENANT'S PERSONAL PROPERTY.

The Lease has been executed by the parties on the dates indicated below.

______________________________	______________________________
Landlord's Signature	Date
______________________________	______________________________
Landlord's Signature	Date
______________________________	______________________________
Landlord's Signature	Date
______________________________	______________________________
Tenant's Signature	Date
______________________________	______________________________
Tenant's Signature	Date

This form was completed with the assistance of:

Name of Individual: ______________________________
Name of Business: ______________________________
Address: ______________________________
Telephone Number: ______________________________

Early Termination Fee/Liquidate Damages Addendum

[ ] I agree, as provided in the rental agreement, to pay $______________ (an amount that does not exceed two months' rent) as liquidated damages or an early termination fee if I elect to terminate the rental agreement and the landlord waives the right to seek additional rent beyond the month in which the landlord retakes possession.

[ ] I do not agree to liquidated damages or an early termination fee, and I acknowledge that the landlord may seek damages as provided by law.

______________________________	______________________________
Landlord's Signature	Date
______________________________	______________________________
Landlord's Signature	Date
______________________________	______________________________
Landlord's Signature	Date
______________________________	______________________________
Tenant's Signature	Date
______________________________	______________________________
Tenant's Signature	Date

Florida Statute, Section 83.51 (Landlord's obligation to maintain premises) –

(1)The landlord at all times during the tenancy shall:

- (a)Comply with the requirements of applicable building, housing, and health codes; or
- (b)Where there are no applicable building, housing, or health codes, maintain the roofs, windows, doors, floors, steps, porches, exterior walls, foundations, and all other structural components in good repair and capable of resisting normal force and loads and the plumbing in reasonable working condition. The landlord, at commencement of the tenancy, must ensure that screens are installed in a reasonable condition. Thereafter, the landlord must repair damage to screens once annually, when necessary, until termination of the rental agreement.

The landlord is not required to maintain a mobile home or other structure owned by the tenant. The landlord's obligations under this subsection may be altered or modified in writing with respect to a single-family home or duplex.

(2)(a)Unless otherwise agreed in writing, in addition to the requirements of subsection (1), the landloard of a dwelling unit other than a single-family home or duplex shall, at all times during the tenancy, make reasonable provisions for:

1. The extermination of rats, mice, roaches, ants, wood-destroying organisms, and bedbugs. When vacation of the premises is required for such extermination, the landlord is not liable for damages but shall abate the rent. The tenant must temporarily vacate the premises for a period of time not to exceed 4 days, on 7 days' written notice, if necessary, for extermination pursuant to this subparagraph.
2. Locks and keys.
3. The clean and safe condition of common areas.
4. Garbage removal and outside receptacles therefor.
5. Functioning facilities for heat during winter, running water, and hot water.

(b) Unless otherwise agreed in writing, at the commencement of the tenancy of a single-family home or duplex, the landlord shall install working smoke detection devices. As used in this paragraph, the term "smoke detection device" means an electrical or battery-operated device which detects visible or invisible particles of combustion and which is listed by Underwriters Laboratories, Inc., Factory Manual Laboratories, Inc., or any other nationally recognized testing laboratory using nationally accepted testing standards.

(c) Nothing in this part authorizes the tenant to raise a noncompliance by the landlord with this subsection as a defense to an action for possession under s. 83.59.

(d) This subsection shall not apply to a mobile home owned by a tenant.

(e) Nothing contained in this subsection prohibits the landlord from providing in the rental agreement that the tenant is obligated to pay costs or charges for garbage removal, water, fuel, or utilities.

(3) If the duty imposed by subsection (1) is the same or greater than any duty imposed by subsection (2), the landlord's duty is determined by subsection (1).

(4) The landlord is not responsible to the tenant under this section for conditions created or caused by the negligent or wrongful act or omission of the tenant, a member of the tenant's family, or other person on the premises with the tenant's consent.

REEFS

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