

A Guide to
Personal
Finance
Options

FINANCIAL

basics



Table of Contents

Introduction	4
Understanding Money Management.....	4
Setting Financial Goals.....	4
Tracking Expenses.....	5
Creating a Budget.....	5
Making Changes to Your Spending Plan.....	8
Staying Motivated.....	9
Managing Your Debt	9
Credit Cards and Personal Loans.....	9
Student Loans.....	11
Deferment and Forbearance.....	12
Payday Loans.....	12
Collection Agencies.....	13
Your Credit Report	13
Accessing Your Credit Report.....	14
Your Rights.....	14
Your Credit Score.....	15
Errors, Fraud, and Identity Theft.....	16
Home Ownership	18
Types of Mortgages	19
Home Equity.....	19
Reverse Mortgages	20
If You Can't Make Your Payment.....	20
Investing	21
Stocks.....	21
Bonds	22
Cash Equivalents	22
Risk Management.....	22
Planning for Retirement.....	23
Employer-Sponsored Retirement Plans	25
Individual Retirement Accounts	25
Financial Advisors	25
Conclusion	26



Introduction

You face decisions about personal finances every day. From budgeting and saving to credit and debt to planning for the future, the issues surrounding money choices can feel challenging or even overwhelming. However, by taking control of your money and how you spend, save, and invest it, you can push past your financial challenges and reach your goals.

Understanding Money Management

There are probably quite a few things you'd like your money to do for you beyond just covering your day-to-day living expenses. Perhaps you'd like to take an exotic vacation, buy a house, send your children to college, or retire early. By defining your financial goals and keeping those a priority in the money choices you make, you'll be able to develop a financial focus on what's most important to you.

SETTING FINANCIAL GOALS

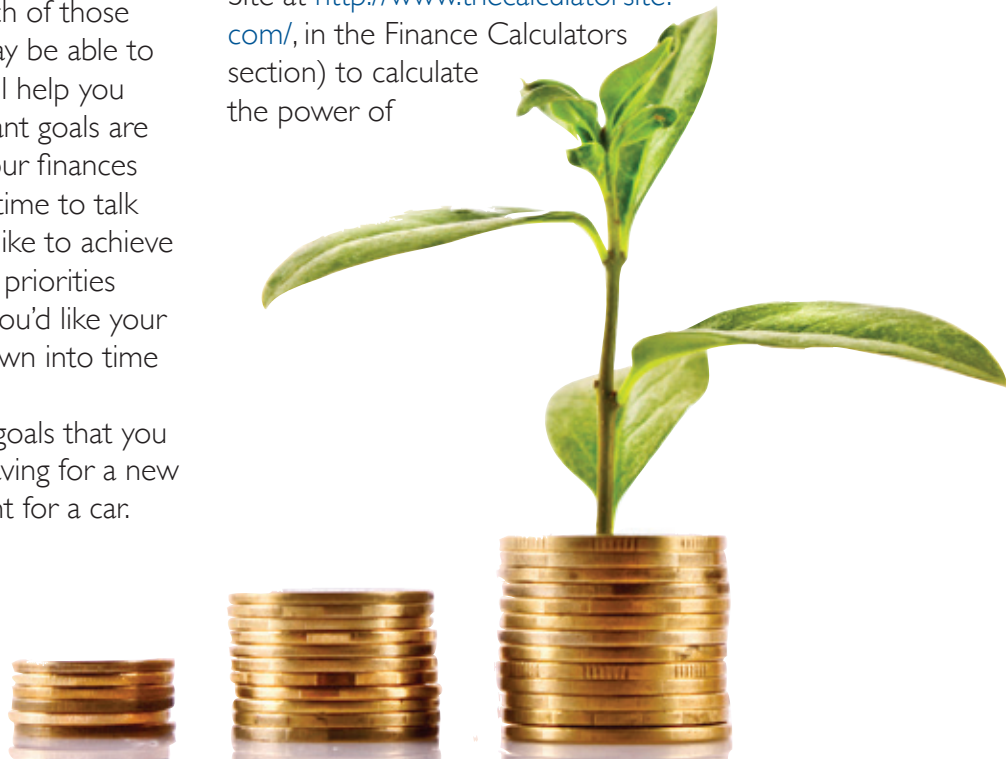
The first step in setting achievable financial goals is to clarify what you want. Like most people, you may have multiple goals you would like to achieve over time. Consider which of those goals are most important. You may be able to reach them all, but prioritizing will help you make sure that the most important goals are taken care of first. If you share your finances with another person, take some time to talk together about what you would like to achieve financially and what each of your priorities are. Once you've decided what you'd like your money to do for you, break it down into time frames:

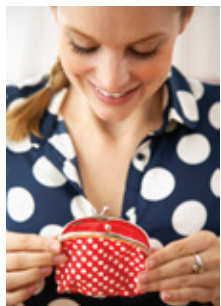
- *Short-term goals* are typically goals that you can reach in a year, such as saving for a new computer or a down payment for a car.

- *Mid-range goals*, like saving for a down payment on a house or repaying credit card debt, typically take 1 to 5 years to reach.
- *Long-term goals* stretch beyond the 5-year mark and are often high-dollar goals like retirement or college tuition for the kids.

It's important to break savings goals into time frames so you can best decide where to stash your cash. For short-term goals, you would most likely use a basic savings account. However, for mid-range and especially long-term savings goals, you would be better off putting the money into accounts that generate a higher interest rate while not providing access to the money. These accounts, especially for retirement and college planning, may have favorable tax advantages as well.

Now that you know what you want and generally when you want it, it's time to get specific. By assigning a dollar figure and achievement date to your goals, you'll know how much money to direct to each one each month. This is pretty simple for short-term goals; simply divide the amount you need by the number of months, and you'll know what to put aside. For longer-term goals, you may need to use an online compound interest calculator (you can find a good one on The Calculator Site at <http://www.thecalculatorsite.com/>, in the Finance Calculators section) to calculate the power of





Tracking your expenses for a week is enlightening. Doing it for a couple of months, however, will give you an excellent picture

compounding interest, interest added to the principal, which is the amount you borrow, of a deposit or loan so that the added interest earns interest as well, working against you if you are paying off credit card debt, or working in your favor in the case of retirement or college planning. If you are currently contributing to a retirement account or have one available through your employer, you can talk to a representative of the company that manages your plan for help with the calculations.

Measuring your progress toward your goals can be extremely motivating. You can set up multiple accounts at your bank or credit union and have the money you've decided to set aside directly transferred to the appropriate account. Keep an eye on your balances to see your progress toward your goal amounts. If, over time, your goals change, you can move the money around to pursue your new financial goal.

TRACKING EXPENSES

Knowing what you need to set aside to reach your financial goals within your time frame is a great first step toward making your money work for you. The next step is to look at what money you have coming in and going out so you can ensure you have the funds available to meet your needs and fund your goals. To do this, start by tracking your expenses. This includes the couple of dollars you might spend on coffee or a snack throughout the day, as well as bigger expenses like grocery shopping, gas for your car, and your monthly bills. You can do this as low-tech as just jotting down the amounts in a notebook, or by using one of the many apps or software tools developed for this very purpose.

of where your money goes. You may even find that tracking expenses and being accountable to yourself (and to someone else if you share your finances and are doing this together) helps curb impulse purchases. Many people are less likely to buy things they don't really need if they know they'll have to write it down and experience the consequence of the purchase on paper.

CREATING A BUDGET

While many people associate the word *budget* with limitations or sacrifice, in reality it's just a plan for how you will spend and save the money you make. Start with your income. Using a budgeting program, an Excel spreadsheet, or old-fashioned pen and paper, put down what you make each month. Be sure to include all sources of income, documented or otherwise, for everyone contributing financially to your household in your budget. The *net income*, the amount you bring home, is what's most important here. Finding what that is for a month can be slightly tricky, as there are more than 4 weeks in a month:

- If you're paid monthly, use that number.
- If you're paid twice a month (for example, on the 1st and the 15th of the month) multiply your take-home pay by 2.
- If you're paid every 2 weeks (for example, on alternate Fridays) multiply your take home pay by 26 and divide by 12.
- If you're paid weekly, multiply your weekly pay by 52 and divide by 12.

- If your pay varies throughout the year, look at what you made last year. If it seems realistic that you'll do the same this year, divide last year's take-home pay by 12 to project this year's average monthly income. If you project you'll make much more or less, modify your projection for this year accordingly. On months that you bring home more than the projected amount, be sure to set aside the extra funds to cover months when you bring home less.
- If you are eligible to receive an annual bonus, don't include that as part of your regular income for your ongoing budget, but keep in mind your financial goals when deciding on how to spend it.

While your budget will mainly be driven by your take-home pay, this is also a good time to look at your tax withholdings. If you're having more money than necessary taken out of your paycheck so you can get a large refund, you may be better off changing that and moving the extra money to an interest-bearing account or into your monthly cash flow. If you're not having enough withheld and end up owing the Internal Revenue Service each year, consider modifying your withholdings so you don't have a difficult tax debt burden on your hands in the spring.

If you've been tracking your expenses, then getting started with making a plan for how to spend your money will be pretty simple. Even if you haven't, an honest assessment of what you think you spend is a good starting point. If you use a debit or credit card for many of your expenses, a review of your recent statements will help. Expenses can usually be broken down into two sets of categories: *essential expenses* versus *discretionary expenses*, and *consistent expenses* versus *periodic expenses*.

Essential expenses are things you simply need to have. For most people this includes things like housing, transportation, and food. Discretionary expenses are things you want to have, such as dining out, entertainment, and vacations. Consistent expenses arise each month, like your rent or mortgage payment. Periodic expenses happen only once in a while, such as car repairs. Consistent and periodic expenses may be essential or discretionary.

This chart is an example of different expenses and how they break down into these categories. You may not have all of the ones listed and may have additional expenses. Further, what's essential to one family may be discretionary to another. Use this chart to start thinking about your expenses and which are most important to you.



	CONSISTENT	PERIODIC
ESSENTIAL	Housing Utilities Transportation Food Child care Debt repayment Savings	Property taxes Home or auto repairs Medical expenses Clothing
DISCRETIONARY	Cable television Gym membership Entertainment Dining out Coffee Hobbies	Vacation Gifts

As you are listing your expenses for your budget, start with your consistent essential expenses. Some of these, like utilities, will vary throughout the year. Try to find the average amount for a year, and use that for your budget plan. Next, determine what you think you've spent in the past year on periodic essential expenses, and decide if you think that's a realistic amount for the coming year. Be brutally honest with yourself. For example, if you've had no home or auto repairs for the past few years, you may be tempted not to budget for any. However, if you have an older home or your car has been on the road for a while, you may be due for some maintenance costs. Once you've decided on your amounts, divide them by 12 and add them to your spending plan. You can have those funds automatically transferred into a savings account you can turn to so you don't have to resort to credit cards when the roof starts leaking.

Go through the same process with your consistent and periodic discretionary expenses. These may be a bit more challenging, because they are less likely to be specific bills to pay than they are miscellaneous unplanned expenditures that some people call spending money. If you haven't been tracking your spending, use your debit and credit card statements to get your best guess. By tracking your expenses going forward, you can fine-tune this area.

Payments to your creditors will need to be included in your budget. For your first draft, just include your minimum payments. If one of your goals is to get out of debt, you can increase the payments after you determine that your essential expenses are covered. If you have high-interest debt, paying only the minimum payment can lock you into payments for decades and cost you a fortune in interest and fees. It's in your financial best interest to find the funds to increase these payments.

Savings is an often-overlooked but essential part of any budget or spending plan. For most people, having easily accessible funds in an emergency savings account is critical. Work toward putting away 3 to 6 months of your essential expenses in this account. If you have an unexpected crisis, this can



make the difference in keeping your head above water. Once you've established your emergency savings, you can focus on saving for goals.

In your budget, include the dollar figures you determined would need to be set aside to reach your goals in the timeline you chose. Some of that money may be earmarked to repay debt more aggressively, some may be used to increase contributions to a retirement plan, and some may be going to a basic savings account to cover next year's holiday expenses. No matter what the money is for, be sure to note it in your budget plan.

Now that you have your income and expenses, including debt payments and savings accounted for, it's time to put it all together. Add together all of your expenses and subtract them from your income. If you break even or come out

ahead, you are ready to put your plans in place to reach your goals. If there's a shortfall, don't despair. You have options.

MAKING CHANGES TO YOUR SPENDING PLAN


When your numbers just don't add up, you are left with three options: increase your income, decrease your expenses, or postpone reaching your goals. If your income is sufficient to cover your basic living expenses but not enough to save as much for your goals as you'd like, you can choose between drawing out the goal period or making changes to your budget. If your income isn't covering your basic expenses, you'll certainly need to look at making changes. You may have some options for increasing income:

- If you get a large tax refund each year, modify your withholdings to get that money in your paycheck.
- Explore part-time work.
- Encourage other members of your household to contribute to the household expenses.
- Sell assets. Be aware, though, that liquidating certain assets may have tax consequences.

Many people find that it's easier to adjust their expenses than their income. This can be done in a variety of large and small ways.

- Make and pack your own coffee, lunch, and lunch for the kids.
- Reduce dining out expenses by meeting friends for coffee or other less expensive activities.
- Refinance your mortgage or car loan if you can qualify for a lower rate and the long-term cost is reasonable.
- Shop sales and use coupons.
- If you have a cell phone, cancel your land line.
- Reduce or eliminate cable television.
- Use public transportation or carpool.





These are just a few ideas to get you started thinking about changes you can make. Get together with everyone you share your household finances with, and look at what you've been spending. Figure out together what's most important to you and what things you might be willing to reduce or even do without. Look honestly at your wants and needs, and compare those with your goals to see what you value the most. By making educated choices about your money, you can take control of your spending plan and reach your financial goals.

STAYING MOTIVATED

Using a balanced spending plan to manage your money and work toward your goals can be very satisfying. However, it's easy to lose motivation over time. If you fear you'll be tempted to throw all of your careful tracking and planning out the window after a few months, try some of these methods to stay motivated:

- **Put pictures of your goals everywhere!** Put one in your wallet, one on your computer, one on your front door, or one anywhere else you can think of that will help you remember what all of this is for.
- **Avoid temptation.** If you're trying to cut down on shopping, stay out of the mall and unsubscribe from e-mails from your favorite stores.
- **Solicit help.** Let your friends and loved ones know what you are doing so they can support you and not inadvertently tempt you by inviting you shopping or to expensive restaurants. Instead, you can plan less expensive get-togethers.
- **Budget for small treats and rewards.** Don't deny yourself every pleasure in life.

Put a bit of money in your budget plan for small luxuries, or schedule a reasonable reward for hitting certain savings or debt repayment benchmarks.

- **Monitor your accounts.** Watching your balances grow each month can keep your enthusiasm levels high.
- **Be kind to yourself.** You may veer off course from time to time. That's not a failure; it's just a setback. Return to your plan, revise it if necessary, and keep going.

Managing Your Debt

While certain types of debt can be an investment in your future, excessive debt can easily derail your plans for your money. Incorporating into your personal financial plan an assertive strategy to manage and delete your debt can help you save over time and use more of your money to reach your goals.

CREDIT CARDS AND PERSONAL LOANS

Credit cards provide convenience, especially when traveling, and many have inviting perks like airline miles or cash back on purchases. Overuse of credit cards, however, can be extremely expensive. The combination of increasing balances, low minimum payments, fees, and high interest rates can result in years





of repayment and thousands of dollars in interest and fees. Paying off your credit card debt or personal loans efficiently is a matter of making sure your payments significantly outweigh your use, as well as the monthly interest.

If your goal is to get out of debt, the first step is to stop using your credit cards. This can be challenging, but if you've created a balanced spending plan and set aside some cash for emergencies, it will be easier. If you choose to keep a credit card in use because of its perks or for the protection it may provide for traveling and large purchases, be sure that you pay for any new charges each month, as well as at least the requested minimum payment. This will keep you on track for getting out of debt while you take advantage of the benefits the card provides.

The low minimum payments that many credit cards offer can make repayment feel easy in the short term but end up costing a fortune in the long term. To speed up the repayment process and save money, consider ways to increase your payments. These may be reducing nonessential expenses to increase payments consistently, or occasional payment blasts when you get a bonus, a large commission, or other windfall.


The other key factor in efficient debt repayment is reducing interest rates. Depending on your credit standing and other financial factors, you may have quite a few options to explore.

- **Request reduced rates**—The world of credit is competitive. If you have a decent credit history, it's likely that several financial institutions will vie for your business. Let



your creditors know that you're considering transferring your balances elsewhere, and you may find yourself with a better rate.

- **Transfer balances**—If your financial institution won't give you a low rate, find one that will. If you're getting preapproved offers in the mail for a low-rate card, look into making the switch. Both <http://www.consumerreports.com/> and <http://www.bankrate.com/> provide details and comparisons of financial products. If you decide to transfer your balances, check the fine print to be sure that the low rate being advertised will last more than a few months, and that it won't skyrocket to an exorbitant one.
- **Tap into home equity**—If you have *equity* in your home, meaning that your home is worth more than you owe on it, you may be able to refinance your mortgage or get a home equity loan at a lower rate, which you can then use to repay your higher-cost debt. There may even be tax advantages to this strategy. Consider this option carefully before jumping in, however, and look at the total cost of the new loan. The closing costs and the fact that most home loans are repaid over a longer period of time may make this option as expensive as the original higher-rate debt. Additionally, if you find yourself unable to make the new payment, you can be putting your home at risk.
- **Debt repayment plans**—Many credit counseling organizations offer structured debt repayment plans to help consumers get out of debt. They negotiate with creditors on behalf of consumers to try to reduce interest and fees. The consumer pays the debt, plus a monthly fee, through the credit counseling agency over a 3- to 5-year period. Depending on which creditors you owe, this can be an efficient way to get out of debt but can also have credit consequences.



Many debt repayment strategies involve moving balances to new accounts, which leaves the old accounts with a zero balance. For some people, this is an invitation to go on a spending spree. If you think you'll be tempted to overdo it, plan to close those old accounts. Keeping them open may bring some benefits to your *credit score*, a number assigned to your credit history indicating the level of risk you represent to lenders; however, if it's going to result in overwhelming debt, close them and work on your credit score through other strategies.

Some organizations offer *debt settlement negotiation*, a repayment strategy in which you offer to pay a lump sum that's less than your balance to a creditor if the creditor agrees to consider the debt paid in full. This can be expensive, can result in significant credit damage, and doesn't always work. If your accounts are current, there is little incentive for a creditor to take less than the amount owed. If you have older accounts with collection agencies, however, you may be able to make this kind of an arrangement on your own. Make your offer in writing, and make sure you get the agency's commitment in writing. Be aware that there may be some tax consequences to a

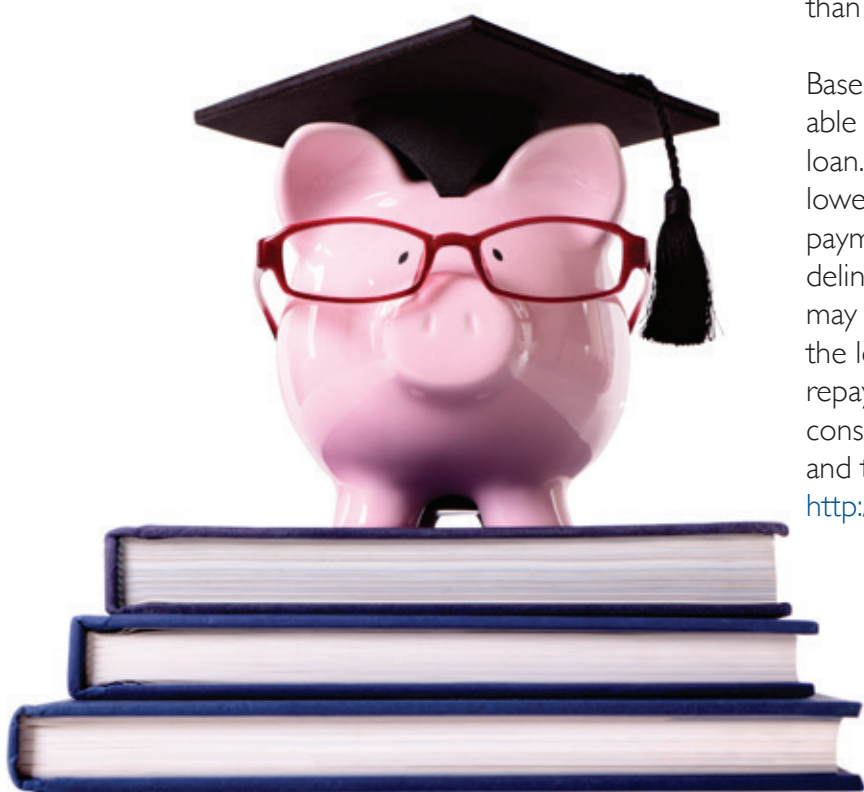
settlement, and you may get notification at the end of the tax year that you owe taxes on the portion of the principal that was forgiven.

STUDENT LOANS

Student loans are a significant financial challenge for both young people right out of college and those who are still struggling with getting them paid off years later. They are unique loans with a variety of repayment plan options and certain flexibility in *deferring*, or suspending, payments that many other types of loans don't have. However, there are significant consequences of nonpayment of student loans. These loans are very difficult to discharge in bankruptcy, and if unpaid, can haunt your credit report for years to come, beyond the 7-year reporting period for most debts.

It's not unusual for student loan borrowers to have multiple loans, both private and federal. Generally, students first maximize their federal student loans and other sources of financial aid granted through their financial aid application package, and then make up the difference with private student loans that come directly from financial institutions, which may be more expensive and have less flexibility than federal loans.

Based on your loan combination, you may be able to consolidate multiple loans into one new loan. This can make repayment simpler, possibly lower your interest rate, lower your monthly payment by extending the loan, and even bring delinquent accounts current. However, you may lose some rights to cancel your loans, and the loans can cost more in the long term if the repayment term is extended. You can shop for consolidation loans through private lenders and the U.S. Department of Education at <http://www.ed.gov/>.



DEFERMENT AND FORBEARANCE

If you're going through a short-term hardship, you may be able to suspend payments on your federal student loan for an agreed-upon period of time, typically in increments of 3 or 6 months. These payment suspensions are known as *deferments* or *forbearance*. A deferment may include suspending interest rates and is typically granted to

- Students with at least half-time enrollment
- Active-duty military members
- Those suffering from a temporary total disability
- Unemployed borrowers

A forbearance allows borrowers to suspend or reduce payments, but interest will continue to accrue on the loan. Because interest may be suspended for a deferment, it's often considered the more desirable choice by borrowers. However, a forbearance may be easier to get approved for.

Some borrowers can qualify for *cancellation* or *forgiveness*, eliminating the responsibility of repayment of some or all of their federal student loans in cases of permanent disability or in which the borrower works in certain high-need fields and communities, such as teaching, health care, legal assistance, or as a government volunteer.¹

There are several repayment plans available for federal loans, and many private lenders offer similar plans. If the monthly payments for your student loans are too high for you to afford, contact your lender about an alternative plan.

- **Extended plan**—This plan can allow you to draw out your repayment period from the standard 10 years, up to 25 years. Be aware that interest will accrue throughout this period, so extending your loan will cost

¹ FinAid. (n.d.). *Loan forgiveness*. Retrieved September 28, 2014, from <http://www.finaid.org/>



more in the long run unless you eventually accelerate your payments.

- **Graduated plan**—If it is likely that your income will increase over time, a graduated payment plan may be appropriate for your needs. Payments start very low and are increased every 2 years.
- **Income-contingent plan**—In this plan, your financial circumstances are assessed by the lender annually, and the payments are adjusted accordingly.

PAYDAY LOANS

Payday loans, whether obtained through a storefront lender or online, can be one of the most expensive forms of credit available. Typically, the borrower provides the payday lender a postdated check or approves a future account debit for the amount of money he or she wants to borrow, plus a 10% to 25% fee for the lender. The lender gives the borrower the cash and deposits the check or debits the account on the agreed-upon date, which is usually the next payday. On that payday, if the borrower wants to avoid having the funds deducted from his account, he has the option of paying the fee and rolling over the loan, which generates new fees. Many borrowers create a cycle of paying fees and rolling the loan over and over, sometimes having multiple cycles with multiple lenders. The average payday



wage garnishment (a portion of your paycheck being withheld to pay the debt) or asset seizure (usually consisting of funds being taken from a bank account to pay the debt).

loan borrower has nine transactions, with an effective annual interest rate of over 400%.²

It can be extremely challenging to break the cycle, but necessary in order to establish financial control. The first step is finding the funds to let the check be deposited and not roll over the loan. Even if this means selling an asset, sacrificing some expenses for a month, or taking a cash advance on a credit card, this one-time hardship will save you a fortune down the road. The next step is to examine your situation to see what drove you to the payday loan in the first place. If your budget is unbalanced, start over with a new one to help you live within your means. If you had an emergency, revisit your budget and make a commitment to creating emergency savings so you don't have to commit to such drastic financial measures in the future.

COLLECTION AGENCIES

If an account has gone unpaid for several months, the creditor may hire or sell it to a *collection agency*, a company that buys debt from creditors for a portion of what's owed, or is hired on behalf of a creditor. These agencies then attempt to collect the debt from the borrower, usually using very aggressive collection techniques. If they fail, the creditor may or may not choose to take the action further. This decision is generally made based on how much you owe and the likelihood of collecting through legal means. If the choice is made to pursue collection action, the creditor can take you to court, which could result in

Collection agencies may use very aggressive collection techniques. Their activities are regulated by the Federal Trade Commission (<http://www.ftc.gov/>), and they must comply with the *Fair Debt Collection Practices Act*. This prevents collectors from using abusive, unfair, or deceptive practices. Collectors are prohibited from threatening you with action that they don't actually plan to take, harassing you, and causing you problems in the workplace.

Your Credit Report

There are three major *credit reporting agencies* in the United States. They are Experian (<http://www.experian.com/>), Equifax (<http://www.equifax.com/>), and TransUnion (<http://www.transunion.com/>). These are for-profit companies, regulated by the Federal Trade Commission, that collect and compile data from creditors and public records. Creditors purchase this information to use in making credit-granting decisions. Some employers, landlords, and insurance companies also buy the information to use in their hiring, renting, and pricing decisions. Your information can be sold only with your permission or to companies with a legitimate business need. The three credit reporting agencies may have slightly different information on your *credit reports* (reports containing your personal information, credit repayment and application history, and other credit-related information). This is because while most major creditors report activity to all three, many smaller creditors report to only one or two of them.

² Center for Responsible Lending. (n.d.) *Payday lending: How a short-term loan becomes long-term debt*. Retrieved October 6, 2014, from <http://www.responsiblelending.org/>



ACCESSING YOUR CREDIT REPORT

It's a good idea to check your credit report once a year, or before making any major purchases or life changes. You can buy your credit reports directly from each of the credit reporting agencies; however, there are ways to access your reports for free.

- **Annual Credit Report Request Service**—Found at <http://www.annualcreditreport.com/>, this service was established by the credit reporting agencies to provide every consumer a free credit report from each of the credit reporting agencies each year, upon request.
- **Directly from the credit reporting agencies**—If you have been denied credit, are unemployed but looking for a job, are a victim of identity theft or fraud, or are receiving public assistance, you may qualify for a free credit report directly from the credit reporting agencies.

Your credit reports include your personal information, your credit history, and a record of who has reviewed your report in the past 2 years. Your *personal information* includes your name, past names, address, past addresses, Social Security number, employer, date of birth,

and information about your spouse. Your *credit history* is the most significant portion of your credit report. This will show your payment history with your current and past creditors, along with balances, dates of activity, payment amounts, and the types of debt you have. If there is any information about your credit history in the public record, such as foreclosures, bankruptcy, judgments, or other court-ordered collection activity, it will be indicated in this area of your report as well. The *inquiries* section of your credit report indicates which creditors or other businesses have accessed your credit report in the previous 24 months.

YOUR RIGHTS

The credit reporting agencies must comply with the *Fair Credit Reporting Act* and the *Fair and Accurate Credit Transactions Act*, each enforced by the Federal Trade Commission. These acts provide consumers certain rights and responsibilities.

- You have the right to see your credit reports and to access free credit reports annually. You may have access to additional reports in cases of identity theft, fraud, *adverse action* (actions taken by a creditor as a result of your credit history, such as being

Credit Score



Excellent



Average



Poor

denied credit, receiving credit at a higher interest rate than you applied for, or having your accounts closed due to credit activity), or unemployment.

- Most negative information will be removed from your credit report after 7 years. This period starts at the time of the worst delinquency. For example, if an account is *charged off* by a creditor, it's deemed uncollectable by the creditor and sent to a collection agency. This is when the 7-year clock starts ticking. Even if the collection agency sells it to another agency, the time period does not restart.
- You may dispute inaccurate or outdated information, and the credit reporting agency must take action within 30 days.
- Access to your report is limited to those with a legitimate business need, and employers may access your credit report only with your permission.
- You have the right to opt out of prescreened offers of credit or insurance by calling 888-5-OPTOUT (888-567-8688).
- You may place a *fraud alert* (a notice not to grant credit on your behalf without confirming your identity) on your credit reports if you've been a victim of fraud or identity theft.³

³ Federal Trade Commission. (n.d.). *What if you're a victim of identity theft?* Retrieved October 2, 2014, from <http://www.ftc.gov/>

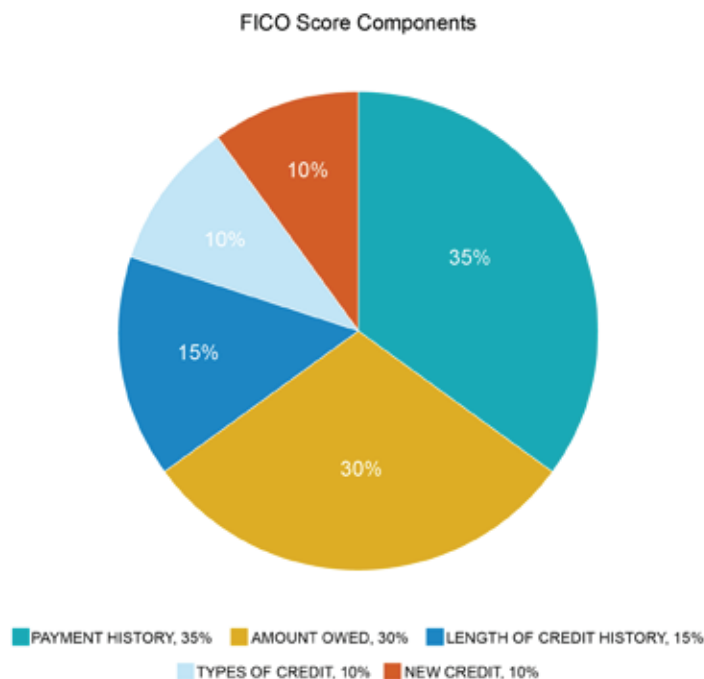
YOUR CREDIT SCORE

Your *credit score* is a number that indicates the level of risk of default you represent to a creditor at a given moment in time. There are several scoring models, but most are based on the *FICO score*, a credit score created by the Fair Isaac Corporation, which is used in most lending decisions. It ranges from a low score of 300, which represents extremely high risk, to 850, representing extremely low risk. The credit reporting agencies are not compelled to provide you a credit score at no cost. However, the scores are available for purchase through the credit reporting agencies and through <http://www.myfico.com/>. The FICO score consists of five components:

- **How you've paid**—The most significant factor in the score, 35% of it, is how you've paid your creditors. Consistent, on-time payments will improve your score. Late or missed payments will have a negative effect on your score. The more frequent, recent, or severe the missed payments are, the greater the impact they will have on your score.
- **What you owe**—Thirty percent of your score is based on how much you owe, particularly in relation to your available balances. Maxing out your accounts can have a detrimental effect on your score. Keeping your balances at half your limits or below can benefit your score.
- **How long it's been**—The age of your accounts impacts 15% of your score. Typically, the longer your credit history, the better. Having a longer credit history gives more data to base lending decisions on.
- **What kind of credit**—Having a variety of credit types is generally a positive for your credit score and shows that you can handle a mix of credit. This is 10% of your overall score.



- **What's new**—Having many new accounts or excessive inquiries indicating that you're applying for new accounts can indicate greater risk, as it looks like you are in need of a lot of credit quickly, which could be indicative of a financial problem. New credit makes up 10% of your credit score.⁴




A significant factor that is not included in credit scores is income. When most lenders make decisions about granting credit, the credit score is only part of the decision-making process. They may also consider income, debt-to-income ratio, and other factors. Lenders who use credit scores in determining whether to grant credit may also use them to determine the price of the credit, a process called *risk-based pricing*. For example, two people may apply for the same loan with the same financial institution. One who has a credit score of 740 may get the loan with an interest rate of 4.2%, while one with a score of 680 may get it with a rate of 6.5%. A third person with a score of 600 may be declined outright.

There are steps you can take to improve your credit score. Making payments consistently and on time is the best practice for a high score. Also, avoid maxing out accounts and submitting excessive credit applications in a short period of time (unless shopping for the best rate on a mortgage or car loan, which most scoring models don't penalize as it's considered generally wise consumer behavior).⁴

ERRORS, FRAUD, AND IDENTITY THEFT

With all the data that credit reporting agencies collect and maintain, there are bound to be errors from time to time. Checking your credit report annually, and at least 60 days before any major

⁴ myFICO. (n.d.) *What's in my FICO score? How my FICO score is calculated*. Retrieved October 1, 2014, from <http://www.myfico.com/>



credit application, can help you stay on top of problems and resolve them before they become a crisis.

If you find information on your credit reports that isn't yours, dispute it right away. If you've gotten your reports online, follow the steps on the Web site to submit your dispute. If you've gotten your report through the mail, use the dispute form included with the report. Indicate what is reported in error. The credit reporting agency has 30 days to investigate the information. If the agency is unable to gain verification from the reporting creditor that the information is in fact accurate within 30 days, it must remove the information from your report.

In cases of *fraud*, you'll find that the accounts on your credit reports are your own but that there is activity that you didn't initiate. Typically this happens when someone gets your account information and uses your existing accounts as his or her own. Contact both the credit reporting agency and the affected creditors. You can place a fraud alert on your credit reports, and you'll need to get new account numbers for the affected accounts right away.⁵ You'll also need to go through the activity to document what was yours and what wasn't, and will likely need to complete *affidavits*, written statements affirmed by oath, often used in court or other legal settings, attesting to that.³

⁵ Federal Deposit Insurance Corporation. (Updated 2014, September 25). *You can fight identity theft*. Retrieved October 2, 2014, from <http://www.fdic.gov/>

Identity theft occurs when someone uses your personal information to create a new credit profile for him- or herself and gets new accounts in your name. The first step to recovery if you've been victimized by an identity thief is to contact all of the affected organizations. These may include your creditors and financial institutions; credit reporting agencies; government agencies, such as the Social Security Administration and Department of Motor Vehicles; and your local law enforcement agency. Often, in order to undo the damage of the identity thief's actions, you'll need a police report. Check all of your accounts closely for unfamiliar activity, and check your credit report every 3 months while going through the process of cleaning up the mess the identity theft left behind.⁶

Identity thieves and people who commit credit card fraud are becoming ever more ingenious. With vigilance, you can protect yourself and reduce your chances of becoming victimized.

- **Check it out.** Review your checking account and credit card activity carefully at least monthly, and carefully review your credit report at least once a year. Report any unusual activity right away.
- **Keep it quiet.** Protect your personal information by not sharing it with anyone; especially someone with whom you didn't initiate contact. Thieves may attempt to get details from you via text, phone, e-mail,

⁶ U.S. Department of Justice. (n.d.). *Identity theft and identity fraud*. Retrieved September 30, 2014, from <http://www.justice.gov/>





or links to fake Web sites. If you're unsure whether to give someone claiming to represent a company you do business with your information, end your communication and contact the company directly through the phone number on its Web site or your statement.

- **Know where your vulnerabilities lie.**

Don't give dumpster divers a chance to get their hands on your information. Shred documents with account numbers or other identifying information. Defy online hackers by using a good antispyware and firewall program, and always use complicated passwords. Clean out your wallet or purse, and put cards or documents you don't need regularly somewhere safe just in case your wallet is lost or stolen. If your mailbox isn't secure, consider switching to online account statements.⁵

Home Ownership

For many people, a home is the largest and most significant purchase of their lives. It's a major expense that shouldn't be entered into without significant consideration, but it can also be a rewarding investment.

Most likely, you're going to need to pay to live somewhere. While some people prefer the freedom from maintenance and long-term commitments that renting provides, many others prefer the security and investment of owning a home. While in certain parts of the country housing bubbles and economic downturn have left people in homes worth far less than they paid for them, in many cases, the value of a home increases over time. There are certain tax advantages available, such as

the ability to write off the interest on the mortgage on your primary home. And for many people, the

security of having their own place and not being subject to a landlord's whims is quite appealing.

As you prepare to purchase your first home, there are some steps to take to get ready to qualify for a *mortgage*, or home loan. First, assess your savings. Most lenders will want to see at least a small down payment (around 3% of the purchase price), plus cash on hand for *closing* costs, the upfront costs of the loan. They also like to see that after you buy the house, you'll still have some money in the bank, called *post-purchase reserve funds*. The greater the down payment you can make, the less you'll need to borrow, making both your monthly mortgage payment and the long-term cost of the loan smaller.

In addition to seeing what you have in savings, the lender will be interested in your credit score. In many cases, the higher your score, the lower your interest rate will be. If your score is too low, below 600, for example, it may be difficult to get a loan at all, or you may be required to come up with a much larger down payment.⁷ Check your credit reports and credit scores several months in advance of applying for a mortgage loan. If you find errors or other problems, start the resolution process right away. It can take a full month for updated information to be reflected on your report. Likewise, if you have old debt in collection agencies, it may be best to pay those off before applying for the loan.

While your monthly income is a major factor in how much you can borrow, another significant consideration for lenders is your debt-to-

⁵ FHA.com. (n.d.). Credit requirements for FHA loans. Retrieved October 3, 2014, from <http://www.fha.com/>

income ratio. This is the percentage of your monthly gross income that goes toward paying debts. Most lenders will not approve a mortgage loan if the mortgage payment plus your other debt payments will exceed 43% of your monthly gross income.⁸ By paying down unsecured or other debt before you apply for a mortgage, you can impact the amount you can qualify for.

TYPES OF MORTGAGES

In general, a mortgage payment is made up of four parts: *principal*, *interest*, *taxes*, and *insurance*, often referred to as *PITI*. You may have a choice of the *term* of your mortgage. The term is the duration of the mortgage. Most traditional primary mortgages are 30-year loans, but many lenders offer 15- and 20-year mortgages as well. Often, the interest rate is lower on a longer loan, and certainly the monthly payments are lower, but the long-term cost of a longer loan is generally significantly higher than a shorter one. How interest is handled varies with types of loans as well.

- *Fixed-rate mortgages* maintain the same interest rate throughout the life of the

loan. If rates are very low when you get your mortgage, this may be a great option. Having a fixed rate provides a sense of stability to many people as well, as they know their payments are unlikely to change significantly over the life of the loan.

- *Adjustable-rate mortgages* begin with a fixed interest rate for a specified period and then adjust according to current rates at specified intervals. This can result in either higher or lower payments, based on how interest rates change. These mortgages can be quite affordable in the beginning but may become challenging over time unless you're confident that your income will adjust as well.
- *Interest-only mortgages* aren't as widely available as other types but are a tool to provide consumers with a more limited budget access to home buying, particularly in markets in which home prices are especially high. With these loans, for the first several years, you pay only the interest. Later, the payment will adjust upward to include both principal and interest.

HOME EQUITY

If you're a homeowner, you may have a financial resource in your home, known as *equity*.

This is the value of your home, minus what you owe on it. For example, if your home is worth \$250,000 and your mortgage balance is \$200,000, you have \$50,000 in equity in your home. Because mortgage loans generally have lower rates than other kinds of loans, and because of the tax benefits, many people access their home equity to repay debt, fund a significant life experience, remodel their home, or achieve another financial goal. Every new mortgage loan will have closing costs to consider; whether you pay them up front or they are rolled into the balance of the loan. Either way, bear these costs in mind when looking at the long-term cost of the loan.

8 Consumer Financial Protection Bureau. (Updated 2013, December 30). *What is a debt-to-income ratio?* Retrieved October 2, 2014, from <http://www.consumerfinance.gov/>





REVERSE MORTGAGES

A reverse mortgage is a specific type of mortgage for senior citizens with significant equity in their

homes. There are a variety of types, some government-backed and others *proprietary* (offered by private lenders), but the general model is the same.

A senior citizen can borrow against the equity in the house. The homeowner can either take a line of credit or receive monthly payments for a period of time or for life from the equity. The loan doesn't have to be repaid until the homeowner moves out, dies, or sells the home. At that point, the loan becomes due and can be paid with the proceeds from the sale of the house or by refinancing the house. Information about reverse mortgages can be provided by financial institutions or from the U.S. Department of Housing and Urban Development at <http://www.hud.gov/>.⁹

IF YOU CAN'T MAKE YOUR PAYMENT

If you've hit on hard times and find you can't make your mortgage payment, you have options. First, consider the scope of the problem. Are you going through a 3-month rough patch, or are you experiencing a life change that will prevent you from handling this mortgage payment permanently? Determine whether you have any equity in the home and what your credit history is like. If you need to lower your payments, have equity, and interest rates are in your favor, you may be able to refinance the mortgage.

- A *home equity loan* is a loan against your home for a portion of the equity in it. These are most often 15-year loans with a fixed interest rate. These loans will result in closing costs that you should consider when looking at the potential savings of the new loan.
- A *home equity line of credit* is similar to a home equity loan, but because it's a line of credit, you can draw from it as needed and repay what you've withdrawn. Most often, these are variable-interest loans.
- *Refinancing* your mortgage involves getting an entirely new loan to pay off the existing mortgage on your home. Typically this makes good financial sense when interest rates have dropped significantly, so the new loan will be less expensive than the old loan. You may choose a *cash-out refinance*, which would be a new loan for close to the current value of your home. This would provide you the funds to pay off the old loan and leave you the leftover cash from your equity to spend. Another way to use mortgage refinancing is to refinance for only the amount you owe, in order to lower your interest rate and monthly payments. Like home equity loans, refinancing will result in closing costs that you should consider when looking at the potential savings of the new loan.

While using the equity in your home to reach goals or add to the quality of your life may be very appealing, remember that loans secured against your home will put your home at risk if they go unpaid.

⁹ U.S. Department of Housing and Urban Development, Federal Housing Administration. (2010, November 1). *Consumer fact sheet for home equity conversion mortgages*. Retrieved October 3, 2014, from <http://www.hud.gov/>



If refinancing isn't an option and you want to keep your home, talk to your lender right away. The best time to do this is before you miss a payment, but even if you've missed a few, pick up the phone. In most cases, the lender has no desire to take your home through *foreclosure* (a legal process of the lender collecting the balance of the mortgage loan by forcing the sale of the home). It's an expensive and time-consuming task, and your lender would rather keep you as a customer, making payments on your loan. If you can make up any missed payments outright, do so right away. If not, there are several payment arrangements the lender may be willing to make.

- *Repayment plans* are payment plans in which you work with the lender to increase your payments over the next several months to make up for past missed payments.
- *Modification* is changing the terms of the loan to add missed payments to the end or to the balance, or even to change the interest rate or monthly payment.
- A *forbearance agreement* will allow you to skip or reduce payments for several months, allowing you time to recover from your financial setback.
- There are several assistance programs under the *Making Home Affordable* program, created by the federal government, to help homeowners who are falling behind on their mortgages. These include both modification and refinance options. Detailed information is available at <http://www.makinghomeaffordable.gov/>.

Investing

Making your money work for you goes beyond managing your money and saving for emergencies. For many people, it means



taking advantage of interest and growth on investments as a way to increase their income and save for the future. There are three basic classes of investments: *stocks*, *bonds*, and *cash equivalents*, with a variety of types within those classes. When considering types of investments, it's important to balance *risk*, the chance of losing your investment dollars, with the likelihood of *return*, the earnings on the investments.

STOCKS

A *stock* is a share of ownership in a company. Stocks are generally considered the investment class that carries the greatest potential for return, but also the greatest risk.¹⁰ There are two primary types of stock: common and preferred. Common stock is ownership in a company, providing voting rights and potential dividends. Preferred stock provides no voting rights but often has guaranteed dividends. Aside from dividends, most money earned by investors in the stock market is through selling shares of stock for more than they paid for it. Stocks are further divided into classifications.

- *Defensive stocks* promise a consistent dividend and stable earnings regardless of the state of the market.
- *Growth stocks* are projected to grow at a faster rate than the market average.
- *Income stocks* pay steady, potentially increasing dividends, and often have less volatility than the overall market.
- *Speculative stocks* come with a high degree of risk but have the potential for significant returns.

¹⁰ Investopedia. (n.d.). *Investing 101: Types of investments*. Retrieved October 2, 2014, from <http://www.investopedia.com/>

- *Value stocks* trade at a lower price and may be considered undervalued.

You may also hear stocks classified as *small*, *mid*, and *large cap stocks*. These classifications refer to the size of the company and the categories have been refined to range from the smallest classification of *nano cap* (under \$50 million) to *mega cap* (over \$200 billion). It's generally thought that the larger cap stocks represent less risk than the smaller ones, although that certainly can vary. The big cap stocks may also be known as *blue chip stocks*, shares of companies that have a widely recognized positive reputation and history of financial success.

BONDS

Bonds are a lending investment. You lend money to an organization or government in exchange for interest throughout the life of the bond. At the end of the bond period, you receive your original investment back. Bonds are generally considered a safer investment than stocks, but with a more conservative return.¹⁰

However, there may be tax benefits to bonds that make them more desirable than the yield (the amount you get back on the bond) indicates.

- *Corporate bonds* are issued by nongovernment companies, much the way they issue stock. While generally less risky than stock, corporate bonds carry some risk, as you could lose your money if the company fails.

- *Federal bonds* are issued by the federal government, usually the U.S. Department of the Treasury. They are generally considered extremely safe investments.
- *Municipal bonds* are issued by local and state governments. The returns are exempt from federal taxes and may be exempt from state or local taxes as well.

CASH EQUIVALENTS

Cash equivalent investments are easily converted into cash. With these accounts, you have very minimal risk of losing your investment principal, but they also offer the least return. One danger of keeping too much of your money in a cash equivalent is that it may not keep pace with inflation. Cash equivalents may be checking and savings accounts, certificates of deposit (CDs), or money market accounts.

RISK MANAGEMENT

There is risk inherent in any investment. After all, no one knows what the future will bring. What you can do is look to the past to see how different investments have performed and make balanced and educated decisions. Diversifying your investments with a mix of higher risk, higher return stocks, more conservative bonds, and extremely safe but not particularly profitable cash equivalents can be the solution to balancing growth and risk.

Many people choose to find diversification through investing in *mutual funds*. These are funds managed by a professional that



include a mix of different stocks, bonds, and cash equivalents. There are many mutual funds to choose from, some more aggressive than others. There are also funds that may have an emphasis on a certain type of industry or on socially responsible organizations.

Asset allocation is an investment strategy that takes into account your comfort level with risk, the amount of time you have to invest, and your personal financial goals. For example, a person with a long timeline to invest for retirement, who is not risk-averse, may have a portfolio with a large proportion of stocks, with just a small number of bond or cash equivalent investments. Those who are getting closer to their financial goals, perhaps just several years from retirement, may instead choose to have fewer stocks to minimize volatility in their portfolios, and focus more on bonds and cash equivalents. The key is to remember to adjust the portfolio as your goals and timeline change.

Another risk management strategy is *dollar cost averaging*. This is the process of investing consistently over time no matter what's happening with the individual investments in the portfolio. When the prices of the shares are low, you buy more of them. When they are higher, you buy fewer. The idea is that ultimately the growth of the investments provides a better return than you'd find if you spent your time chasing investments on their way up or down. While some people have made a fortune trading individual investments and timing how they buy and sell them, many others have lost a significant amount of money by doing so.

Planning for Retirement

As you look forward to retirement, think about what that looks like for you and for whomever you share your life with. Many people have

only a vague idea of what they'd like to do, or even when they'd like to do it. Give some serious thought to how you'd like to live your life in your later years. Will you work forever or wrap things up on the job as soon as you turn 65? Will you travel the world or stick close to home catching up on all the reading you didn't have time for during your career? Whatever you choose, making decisions today about how you'd like to spend that time can help you make the retirement planning choices that will allow you to live out your postwork years how you want.

Once you know what your ideal retirement looks like, consider when it will happen. For many people, the question of when it will be is answered by, "Whenever I have enough money!" While you may not be able to retire in just a couple of years if you don't have anything saved yet, by taking control of the process and thinking through what your needs are, you can plan to have what you need at the time you'll need it.

First, figure out what you'll need. Of course it's impossible to project every retirement expense you'll have, but you can start by creating a budget for it. If you're currently working with a spending plan, that's a great baseline to modify for your projected retirement expenses. If you don't currently have a budget in place, track your expenses for a month or two to get a good idea of what you're spending.

Think about what will be different when you retire. You may have some areas of spending that will be reduced by that time. You'll likely no longer be contributing to a retirement plan, for example. Work-related expenses such as dry cleaning, commuting costs, and meals purchased during the workday will likely be reduced or eliminated. Perhaps your mortgage will be paid off. On the other hand, you may have some increased expenses in areas like health care, travel, or hobbies. Review each expense carefully, and consider how you'll spend in the future. Remember to adjust for inflation. Over the past 100 years, the average annual inflation has been 3.2%.¹¹ If you're not going to retire for some time, you can assume that a purchase made in your golden years will be more expensive than if you were to make it today. An inflation calculator, such as <http://www.usinflationcalculator.com/>, will help you with your projections.

¹¹ InflationData.com. (2013, April 15). *Average annual inflation rates by decade*. Retrieved October 2, 2014, from <http://www.inflationdata.com/>



Next, review the sources of income you'll have in retirement.

- If you plan to work part time, research what you might be able to earn in your chosen field.
- You've likely paid into Social Security throughout your working life. Visit <http://www.ssa.gov/> to estimate what your benefits will be. They will vary based on your age at retirement, so the longer you wait, the more you'll be eligible to receive monthly.
- If you've been investing on your own or through an *employer-sponsored retirement plan* such as a 401(k) or 403(b) plan, check in with an advisor through your plan administrator to see if your allocations are where you want them to be and to project the growth of the accounts.
- While not as popular as they once were, some employers and government agencies provide *pension plans* (investment plans that they contribute to on their employees' behalf) for their employees. If you have one, meet with the plan administrator to project what that will amount to at retirement age.
- Consider any other sources of income you might have as you near retirement. Will you have rental properties that will generate income? Perhaps you expect to inherit funds from an older family member. You may have assets that you'll want to liquidate or draw from in retirement, including tapping into the equity in your home through a reverse mortgage.

Once you've projected your retirement expenses and income, you'll need to think about your life expectancy. After all, you don't want to run out of money. The Social Security Administration has a life expectancy calculator, available at <http://www.socialsecurity.gov/> in the Benefits section, to help you with this.

Now that you've computed how long you'll live, how much you'll want to spend, and how much income you'll have, you can put the numbers together to see if you're on track with your retirement savings. If the numbers don't balance, you can choose to work longer, modify your projected retirement lifestyle, or save more aggressively for retirement today.

EMPLOYER-SPONSORED RETIREMENT PLANS

Many employers offer *tax-deferred retirement plans*, such as 401(k) and 403(b) plans. These are very easy to use, as your contributions are automatically deducted from your paycheck. Your employer may even provide matching contributions up to a certain percentage of your income. Not only can these plans provide you consistent savings for retirement, but they offer tax advantages as well. Because the contributions are tax-deferred, the money is deducted from your paycheck before your taxes come out, so you're taxed only on the remainder of your pay. You will have to pay taxes on the accounts when you withdraw funds from them; however, long-term growth on this pretax money can help set you up for a comfortable retirement.

Be aware that there are some restrictions on how much you can save in these types of accounts. Furthermore, there are significant penalties to early withdrawal, although in some cases you may be able to borrow from your plan.

Many employer-sponsored tax-deferred retirement plans offer a variety of funds, with different mixes of stocks, bonds, and cash equivalents to invest in. Contact your plan's administrator (check with your human resources department for contact information)



to meet with an advisor who can help you choose the plan that best meets your timeline, risk tolerance, and goals.

INDIVIDUAL RETIREMENT ACCOUNTS

A traditional *Individual Retirement Account (IRA)* is a retirement plan that you fund on your own, separate from your employer plan. The accounts are generally funds made up of a mix of investment types to choose from based on your timeline, goals, and comfort with risk. Depending on your income, employment status, access to employer-sponsored retirement plans, and other factors, these accounts may provide some very desirable tax benefits at the time of contribution, but remember that you'll pay taxes when you withdraw the money in retirement. These accounts are intended to fund your retirement, so you'll find considerable penalties if you withdraw early.

Roth IRAs are retirement plans that don't have tax benefits at the time you contribute to them, but the withdrawals on both the contributions and growth at the time of retirement are tax-free. You may be able to withdraw from direct contributions tax-free prior to retirement. Be aware that there are contribution and income limits to take advantage of these plans.

FINANCIAL ADVISORS

Retirement planning is such a critical element of your financial life, and it can be quite complicated. How much to save and in which types of accounts, insurance considerations, estate planning, and tax planning can all combine to make you want to just put it off for another day. However, every day you don't

plan for retirement is a missed opportunity to get closer to your goals. If it all feels too overwhelming or you want to be more confident in the choices you make, get help.

There are several types of financial advisors. They may be fee-based or free. While free financial advice sounds like a better deal than fee-based, always consider the source. Many financial institutions offer free financial planning. The financial advisor will likely have the expertise to answer your questions and provide you guidance, but will recommend funds and products provided by the organization he or she works for. This is not necessarily a bad thing, provided that the financial advisor works for a legitimate organization with a variety of options.

Fee-based planners don't have a financial motivation to direct you to certain types of plans, but they can be expensive. If you meet with a fee-based financial planner who will charge you by the hour, be sure to do your homework ahead of time. Bring your completed budget; think about your goals, risk tolerance, and retirement timeline; and be familiar with

what you've already saved for retirement. That way you can spend your time working on making plans for the future instead of sorting through information you can pull together on your own.

Conclusion

The financial choices you make will shape your life today and for the future. Setting realistic goals, managing your money, controlling your debt, avoiding high-cost financial products, and planning for the future all combine to ensure that you will have the funds you need to live your life in the way you want, providing both peace of mind and the ability to afford what's most important to you. Making educated decisions and taking the proper steps to prepare when taking major financial steps, like a home purchase, can save you from costly missteps. It may take some discipline, some planning, and some determination, but the payoff will be worth it. By arming yourself with information, being cognizant of your spending and other financial choices, seeking help when necessary, and keeping an eye on your goals, you can make your money work for you.





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