



**ACEC**  
AMERICANS FOR  
CONSUMER EDUCATION  
AND COMPETITION

*Fostering Consumer Education and  
Financial Literacy While Promoting  
Competition in the Marketplace*

## **PERSONAL FINANCE AND FINANCIAL PLANNING: A WEB-ASSISTED APPROACH**

*Prepared for Americans for Consumer Education and Competition*

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## I. How to Use this Guide

This is a web-assisted guide to personal finance. The objective of this guide is to aid teachers and students in the area of personal finance. For teachers, this guide is source base for teaching personal finance. For students, the guide serves as a self-teaching tool.

**For Teachers:** This guide helps in assisting teachers to locate websites on topics dealing with personal finance. Each lesson is self-contained and can be taught independently. The lessons are intended to supplement materials already employed in the classroom. There are excellent websites that have more comprehensive lesson plans, complete with exercises (see <http://www.edgate.com> and its section on “Practical money skills for life.” This guide is intended to be used in conjunction with sites such as edgate’s.

Each lesson contains objectives and key terms. The objectives are an integral part of the lesson plan. Each objective is listed at the beginning of the lesson plan and then is discussed in detail. It is then simple to spell out the objective and then to concentrate on accomplishing the objective before proceeding to the next topic. Each lesson also contains helpful hints in “A Word to the Wise” and “Another Word to the Wise”. Teachers may wish to supplement these hints with examples of their own personal experiences and experiences from the students.

A suggested method of teaching the material is to first cover Topic I: UNDERSTANDING THE IMPORTANCE OF PERSONAL FINANCE and Topic II: FINANCIAL PLANNING. With a firm basis of knowing why personal finance is important and how to budget, the other topics can be covered in any sequence. Teachers may want to consider having the class develop a budget during the first week of class and grade them on how they adhere to the budget over the school term. Here there should be no winners and losers. Even those students who fall short of adhering to their budget should also receive credit for trying.

**For Students:** Students will probably think that they know all about using the World Wide Web. However, with 1,978,560 sites listed under “personal finance” on a popular search engine you can make their searches more efficient and more fruitful if they look at the information at the Spider’s Apprentice at

<http://www.monash.com/spidap.html>

Students can use the materials in this guide to answer such questions as

1. Should I have a budget?
2. How can I realize my financial goals?
3. Should I go to college?
4. Should I have a credit card?
5. How can I manage my finances?

6. Should I have a checking account?
7. How do I shop for a bank?
8. How do I shop for a car?
9. How do I shop for a house?
10. What type of insurance should I have?
11. How much should I save?
12. What sort of investments make sense?

Perhaps the best way to approach the lessons is read each lesson completely to see what is covered. Then go back over the material carefully. The websites in each lesson are helpful in explaining the material and provide insights to the issues raised in the lessons. Go to each website and if there are illustrations or problems, work through them. The illustrations are interesting and informative. Don't ignore them!

Read the first two lessons first. Then you can pick and choose because you will have the basic foundations necessary to cover the rest of the lesson plans. Enjoy!

## **II. UNDERSTANDING THE IMPORTANCE OF PERSONAL FINANCE**

### **LEARNING OBJECTIVES**

1. TO UNDERSTAND WHY IT IS IMPORTANT TO MANAGE PERSONAL FINANCES WISELY.
2. TO BE ABLE TO THINK ABOUT FINANCIAL OBJECTIVES AND HOW TO ATTAIN THEM.
3. TO UNDERSTAND THE CONSEQUENCES OF MAKING DECISIONS.
4. TO SEE IF COLLEGE IS A GOOD INVESTMENT

### **KEY TERMS**

1. SAVINGS
2. INVESTING
3. DEBT MANAGEMENT
4. COMPOUND INTEREST
5. WEALTH
6. EARNINGS
7. WAGE DIFFERENTIALS
8. ANNUITY
9. HEALTH INSURANCE
10. DISABILITY INSURANCE
11. TERM LIFE INSURANCE
12. WHOLE LIFE INSURANCE

### **I. UNDERSTANDING THE IMPORTANCE OF PERSONAL FINANCE**

#### **A. WHAT ARE YOUR FINANCIAL OBJECTIVES?**

1. WHAT ARE YOUR IMMEDIATE GOALS?
2. WHAT ARE YOUR LONGER-TERM GOALS?
3. DO YOU WANT TO BE A MILLIONAIRE?

#### **B. DO YOU WORK?**

1. DO YOU WANT TO CONTROL YOUR FINANCIAL LIFE?
2. WHAT TO DO WITH YOUR PAYCHECK
  - A. SPENDING IT ALL
  - B. SPENDING SOME – SAVING SOME
3. WHY SAVE?

#### **C. ARE YOU GOING TO GO TO COLLEGE?**

1. DIFFERENCES IN EARNINGS OF COLLEGE GRADUATES AND HIGH SCHOOL GRADUATES
2. THE IMPORTANCE OF INCREASED SKILLS IN THE WORK FORCE

### **LEARNING OBJECTIVE: TO UNDERSTAND WHY IT IS IMPORTANT TO MANAGE PERSONAL FINANCES WISELY**

It is difficult for young people to focus on the future. The pattern evident in most individuals is that early on – through the high school and college years – most young people are dependent upon their parents to pay their bills. If young people work, they tend to work part-time to supplement what they receive from their parents. After the college years, most people are net debtors in that they borrow and incur significant debts – a car and a house. However, during this period, they also save, invest and begin to accumulate wealth. The introduction to saving, investing and debt management can begin even earlier. In high school, many teenagers work, purchase cars and begin to use credit. It is important for them to learn to manage debt responsibly in order for them to save and invest.

People and their budgets fall into three groups: net borrowers, net savers and balanced budget units.

1. A net borrower is one who spends an amount greater than earnings.
2. A net saver spends less than earnings.
3. One who has a balanced budget unit is one in which spending equals earnings.

Most people start out as net borrowers. There is nothing wrong with debt but it is important to realize that by borrowing and spending today, you give up some future consumption. Good things can be acquired now through borrowing such as a car, a computer, a TV, and a college education. However, bad things come from mismanaging your personal finances: bad credit, high costs of credit, no credit and even bankruptcy. What is truly bad is that mismanagement now means that you end up paying higher interest rates than others. That's because you are judged as a greater risk.

**A WORD TO THE WISE:** Why throw your money away with higher interest charges from which you get no benefit? That is just plain dumb.

**ON THE INTERNET:** An excellent all around site on personal finance is the Motley Fool. Go to

<http://www.fool.com>

This site is full of detail with information on how to manage personal finances. Go to "Personal Finance" then go to "Help with your finances."

Also go to

<http://www.edgate.com>

Click on "Practical Money Skills for Life".  
Click on "For Teachers".

**A WORD TO THE WISE:** If you mismanage your finances now, you will pay for it for a long time to come.

**THINGS TO DO**

1. Write down how much you earn a month.
2. Write down how much you spend a month.
3. Are you a net borrower, a net saver, or do you have a balanced budget?

**LEARNING OBJECTIVE: TO BE ABLE TO THINK ABOUT FINANCIAL OBJECTIVES AND HOW TO ATTAIN THEM**

What are your financial objectives? You can focus on short-term objectives, long-term objectives or both.

1. Your short-term objective could be to buy an item such as a car or a computer.
2. Your longer-term objectives could be to get a college education, buy a house or retire as a millionaire.

In order achieve either your short-term objectives or your long-term objectives, you must give up something now and you must let your money work for you. By giving up something now you must begin to save and more importantly to accumulate those savings.

Let's suppose that you decide to save \$500 per month, add to it every month and never touch it. Your money will grow to be much larger. This is the wonder of compound interest. This means that you are earning interest on your interest as well as the amount you put in your account each month. In essence, your money is now working for you.

Consider what happens if you save the \$500, then save \$500 a month at 6% from age 17 until age 65. Assuming that the interest earnings are tax deferred, you will have \$1,676,886 when you reach age 65.

**THINGS TO DO:** See what happens to the total amount accumulated when you change the amount saved per month and/or the interest rate. Go to the financial calculators at either

<http://www.bloomberg.com>

or

<http://www.calcbuilder.com>

Suppose at age 65 you stop paying into your savings and decided to pay yourself the six percent earnings. You would then receive \$100,613 per year or \$8,384.43 per month forever (an annuity) without touching the \$1,676,886. Then in your will you can leave your grandkids the \$1,676,886. Of course, it may not

reasonable for a teenager to save \$500 a month. Then plug into the financial calculators what you consider to be more reasonable numbers. For example, save \$100 a month between 17 and 23, \$500 a month between 24 and 30, \$1000 a month between 31 and 40, \$2000 between 41 and 65 at an interest rate of 6%. Using the calculator in <http://www.calcbuilder.com>, how much do you accumulate?

### **THINGS TO DO**

1. Set some financial goals.
2. How do you plan to attain your goals?
3. What do these goals cost?
4. How much do you have to save to achieve these goals?

### **LEARNING OBJECTIVE: TO UNDERSTAND THE CONSEQUENCES OF MAKING DECISIONS**

You have to make choices and in doing so must give up something to get something. When you decide to save \$500 you give up buying stuff with that \$500. If you decide to purchase a gym set for \$500, you are giving up purchasing \$500 worth of other goods.

It is easy to understand the consequences of making financial decisions. For example, what would you buy if you had \$500? Write down all the things you are giving up that you could have purchased instead. Are you really willing to give up all these other things? Keep in mind that decisions are choices and choices mean that you are giving something up to get something. Although it may seem trivial in choosing one type of motorcycle rather than another, it is less trivial in deciding one career over another. Yet the basic concept is the same: you are giving something up to get something.

Consider the following decision: if you work, what are you going to do with your paycheck? Are you going to spend it all or are you going to spend some and save some? These are important decisions because ultimately they will help you take control of your financial life. "Taking control of your financial life" does not mean living from paycheck to paycheck. It means that you don't spend all you make. You save a certain amount each month. It is important to get in the habit of saving. Remember, by saving you accumulate wealth and in so doing are on your way to financial security.

For more on the decision-making process, go to

<http://www.edgate.com>

Click on "Practical Money Skills for Life".

Click on "For Teachers".

Click on "Lesson 1, Making Decisions".

**TO DO:** Go to the savings section of

<http://www.calcbuilder.com>

See what the impact of saving regularly will have on your wealth.

**A WORD TO THE WISE:** Saving now means that you consume less now but you will end up consuming more later.

**LEARNING OBJECTIVE: TO SEE IF COLLEGE IS A GOOD INVESTMENT**

Are you going to go to college? If so there are important decisions to make. First, what college? You can attend a community college, a four year large university, a smaller college, a public institution or a private institution. Some students are determined to go to a particular university. Others are more flexible. Along with making your choice and going through the application process, you have to think about financing your education. Perhaps your parents will pay. Perhaps you will help pay by getting a part-time job. Perhaps you will get a scholarship or a loan. Perhaps you will pay it all yourself, going to school while working full time. Most colleges offer financial aid, you can go to a college's website and find information on the various types of financial aid. An example is the University of Tennessee's website

<http://web.utk.edu/~finaid/>

Additional information on paying for college is given by the Student Loan Marketing Association (Sallie Mae). Click on Wired Scholar

<http://www.salliemae.org>

In addition financial institutions have lending programs for college students. Go to the individual bank's website or see

<http://www.finaid.com/loans/studentadd.phtml>

In order to estimate the amount of financial aid you need go to

<http://media.kiplinger.com/servlets/FinancialAid1999>

A great site for information on scholarships, including scholarships for minorities is

<http://www.scholarships-free-colleges-grants-minorities.com>

Now that you know about financing your college education, what about choosing a college? For those who want information that ranks colleges and universities, go to the college ratings at

<http://www.usnews.com>

**WORK VERSUS COLLEGE:** The choice of going to college versus going to work is an important one. If you go to college, you will be forgoing at least four years of earnings from the job that you would have had if you had gone to work. However, the current job market emphasizes jobs in the professional, managerial and technical fields. If you have a college degree, you can anticipate earning on average *50 percent* more than if you only had a high school degree. Data also show that the wage differentials by gender and by race are narrowing across all educational levels. Thus, there is a growing demand by employers for workers with high skill levels and as a consequence, a widening of the wage differential based on the workers' educational attainment. Importantly, the wage differentials by gender and by race are narrowing indicating that education is more important than race and gender in the hiring decision of employers.

Therefore, you should seriously consider a college education as an investment that will pay dividends for the rest of your life. Just remember that the higher your income, the greater can be your savings and as a consequence, the greater will be your wealth. If you can earn 50 percent more per year with a college degree, you will be able to save proportionately more as well. As we have seen, greater savings mean more money accumulated over your earning years.

For a detailed discussion on earnings by educational levels, race and gender, see Robert I. Lerman's "Wage Rate Differences Are Widening by Education and Narrowing by Gender and Race" at

<http://www.urban.org/econ/econ2.htm>

For a discussion on racial differences in wealth, see Joseph G. Altonji, Ulrich Doraszelski and Lewis Segal, "Black/White Differences in Wealth"

<http://www.frbchi.org/pubs-speech/publications/periodicals/EP/200/Epart3.pdf>

For information on job search and careers go to

<http://www.college.wsj.com>

If you decide to postpone college or not to go to college, there are job sites you can visit. See

<http://www.careerpath.com>

<http://www.hotjobs.com>

For more on going to work, see

<http://www.edgate.com>

Click on “Practical Money Skills for Life”.

Click on “For Teachers”.

Click on “Lesson 2, Making Money”.

**A WORD TO THE WISE:** College is a good investment.

### **THINGS TO DO**

1. Write down all the choices you make today? What did you have to give up when you made those choices?
2. If you work, what did you do with your last paycheck? If you don't know, keep a record of how you spend your next paycheck. The results may surprise you.
3. Did you save any of your last paycheck? If so, do you save regularly?
4. Are you going to college? If yes, then list the top colleges of your choice. Go to your college's website to find information about it.
5. Go to [calcbuilder.com](http://calcbuilder.com), put in 50 percent more per year than you did in your earlier calculations. What impact does this have on your wealth?

### **HEALTH AND DISABILITY INSURANCE**

If you decide to work, then you should also consider insurance protection. You and most young people are probably not very concerned about health and disability insurance. Most likely, you are very healthy and whatever illnesses you have are not very expensive to care for. However, you may know someone who was seriously injured in an accident. Then you may also know that it was very expensive to care for that person. Although most medical costs are incurred in caring for the very young (premature babies) and the very old, health and disability insurance protects against incurring major medical bills. Even though we all think that “it can't happen to us”, you must understand that it does happen to someone. So “why not us”? You must protect yourself against major catastrophes.

If you are going to work for a company, then you may be covered by a group health insurance plan which covers basic expenses such as the doctor, hospital and pharmaceuticals. You may also be covered by major medical insurance or this may be available to you at an extra expense. Major medical covers catastrophic events. Surely, you have read about someone being paralyzed in an accident. Have you wondered how those expenses were paid? If the person had major medical, then the insurance company would pay those expenses.

Information on disability insurance if you need it is on the Financial Planning Center's site

[http://www.cadvision.com/Home\\_Pages/accounts/mylesr/disablty.htm](http://www.cadvision.com/Home_Pages/accounts/mylesr/disablty.htm)

The Financial Planning Center notes that for most age groups the odds of some type of disability before age 65 are 2.5 to 1. The average duration of these disabilities is 3 years. Not many of us can afford to take a 3 year vacation without pay. Although your pay has stopped, all your expenses continue as does your responsibility to pay them. If you saved 5% of your income each year, 6 months of total disability could wipe out 10 years of savings.

There are three types of disability plans

1. Group disability plans which are usually offered to employees of a company.
2. Associations plans which are offered to members of that association.
3. Private plans which are owned by individuals

For a discussion of these plans see

[http://www.cadvision.com/Home\\_Pages/accounts/mylesr/disablty.htm](http://www.cadvision.com/Home_Pages/accounts/mylesr/disablty.htm)

and see

<http://www.insure.com>

and see

<http://www.insuremarket.com>

**A WORD TO THE WISE:** Don't tempt the odds, get disability insurance. You need disability insurance if you work and especially if you have dependents you need disability insurance.

## **LIFE INSURANCE**

Given that life insurance insures against the loss of life, young people will find it to be the least important form of insurance. Only after starting families will people really have to concern themselves with life insurance. This is because life insurance is for our family and not for ourselves. It is for our dependents. If you are single and do not have dependents, life insurance is not necessary. If you have minor dependents, you need life insurance that will cover the cost of raising your children and covering the cost of their education if you were to die.

What types of life insurance are relevant for those with dependents? The American Council of Life Insurance has prepared a pamphlet entitled "What You

Should Know About Buying Life Insurance”. It is on the Federal Consumer Information Center’s website at

<http://www.gsa.gov/staff/pa/cic/acli/index.htm>

and see Kiplinger’s

<http://www.kiplinger.com/insure/>

All life insurance policies are variations on two basic kinds of coverage: term insurance and whole-life insurance. For young people, term life insurance gives the most protection for your money.

Term life insurance protects for a specified period of time. It has low premiums that increase over the life of the policy. It has a fixed death benefit and no cash value (you cannot borrow against the value of the policy). Whole life gives you permanent protection. It has a fixed cash value that you can borrow against. It has a fixed premium and a fixed death benefit.

**A WORD TO THE WISE:** For young people, term is the way to go.

For quotes on term life insurance, go to

<http://www.selectquote.com>

For life insurance quotes, go to Life Insurance Quotation Express at

<http://www.islandnet.com/~insuranc>

see also

<http://www.insuremarket.com>

**THINGS TO DO:** Figure out how much life insurance do you need. Go to the calculator at

<http://www.calcbuilder.com/cgi-bin/calcs/INS1.cgi/Kiplinger>

### III. FINANCIAL PLANNING

#### LEARNING OBJECTIVES

1. TO UNDERSTAND WHY IT IS IMPORTANT TO SET GOALS AND TO MAINTAIN THEM.
2. TO DETERMINE IF YOU SHOULD HAVE A BUDGET
3. HOW TO FIND HELP FOR FINANCIAL PLANNING

#### KEY TERMS

1. ASSETS
2. LIABILITIES
3. NET WORTH
4. GOAL SETTING
5. SHORT TERM SAVINGS
6. LONG TERM SAVINGS
7. BUDGET
8. EXPENSE RECORD

- II. FINANCIAL PLANNING
  - A. WHY IS IT IMPORTANT
    1. DEFINING YOUR GOALS
    2. SHORT RUN PLANNING VS LONG RUN PLANNING
  - B. SHOULD YOU HAVE A BUDGET?
    1. ASSESSING YOUR FINANCIAL WELL-BEING
    2. YOUR INCOME
    3. YOUR EXPENSES
    4. HOW MUCH SAVINGS SHOULD YOU HAVE?
      - A. SAVING FOR A RAINY DAY
      - B. LONG TERM SAVING
  - C. WHAT HELP IS AVAILABLE TO YOU?
    1. PROFESSIONAL FINANCIAL PLANNERS
    2. THE WORLD WIDE WEB

#### LEARNING OBJECTIVE: TO UNDERSTAND WHY IT IS IMPORTANT TO SET GOALS AND TO MAINTAIN THEM

Financial planning is important in helping you obtain your objectives. What are your objectives? These goals are not limited to the long run. Financial planning can be used for shorter-term targets such as buying a new computer. If this is your short term goal then find out how much the computer costs, when you

would like to buy it, and how much per month you will have to save to purchase it. This is what setting your goals means. Thus, your goals should be concrete ones and well defined.

What are your short-term goals? How much money are you going to have to save to achieve them? What are your long-term goals? How much are you going to have to save per month to achieve them as well? From experience we know that it is difficult to think about the long term at such a young age. Realistically, your financial goals will probably change as you get older but that does not mean that you should not set certain goals now.

Do you know any older people who are not financially independent? Many of us know senior citizens that are dependent upon their younger relatives for financial support or who are dependent upon charity. One of the reasons may be that they did not adequately plan for their retirement and are totally dependent upon Social Security. Why should you end up like that when with a little bit of discipline, you can end up a millionaire living on a sizable annuity and can leave a \$1 million to your heirs. Wouldn't that be better than being dependent upon others?

The importance of goal setting is that it allows you to focus on your objectives. By maintaining your goals, you then get the satisfaction of achieving them while being financially sound. Sure, you can go into debt to achieve all of your goals. However, make your overriding goal financial stability. Then you will have control of your financial life.

What are some short-term goals?

1. Buy a new stereo.
2. Go to the beach for spring break.
3. Buy a new motorcycle.
4. Save for college expenses.
5. Have some money set aside for emergencies.

What are some long-term goals?

1. Buy my first house.
2. Start my own business.
3. Have money for a comfortable retirement.

After you have set your goals, then you should make your ultimate goal financial independence. A part of financial independence will be a goal of saving so much per month.

**A WORD TO THE WISE:** Take control of your financial life or it will take control of you.

## **THINGS TO DO**

1. Write down your short-term goals.
2. Write down your long-term goals.
3. Write down how much savings will be required to meet your short term goals.
4. Write down how much savings will be required to meet your long term goals

For a discussion on the importance of personal financial planning go to the American Institute of CPA's website and click on "Do I Need Personal Financial Planning".

<http://www.cpapfs.org>

Two excellent financial planning sites are

<http://www.efmoody.com>

and

<http://www.improveyourfinances.com>

### **LEARNING OBJECTIVE: TO DETERMINE IF YOU SHOULD HAVE A BUDGET**

Should you have a budget? If you are like most people, you probably dread the thought of having to make a budget. It's tedious. It is time consuming. Yes, but it is also useful. People complain all the time about not having enough money to buy something or go on a vacation. Yet they could if they had established a simple goal (go to Hawaii for two weeks) and planned for it. A budget simply tells you the cash inflows (income) and outflows (expenses). If you budget yourself in as an expense (savings) much like the rent or food then you are on your way to financial independence.

Realistically, budgeting for most of us is just like dieting. Some people can do it successfully but most cannot. This section is for those who can do it. For those of us who cannot, don't give up. Just pay yourself first each month without fail by adding to your savings. If you do that and don't touch it, you will still experience a large degree of financial independence.

**A WORD TO THE WISE:** Pay yourself first each payday.

How to get started? Ask yourself some basic questions.

1. What are my goals?
2. How can I achieve them?
3. Where am I now?
4. If I am barely getting from paycheck to paycheck, can I realistically achieve my goals?
5. How do I plan for the future?

Next, prepare a financial plan. It doesn't have to be elaborate. Simply list

1. Your goals and rank them.
2. Your assets.
3. Your liabilities.
4. Subtract your liabilities from your assets (this is your net worth)
5. Your income per month.
6. Your expenses per month.

Later on in life, your planning will include such items as investments, tax planning, retirement and estate planning. But for now, these six will do. The question "If I am barely getting from paycheck to paycheck, can I realistically achieve my goals?" is an important one. One reason many people exist from paycheck to paycheck is not because they have too little income, its because they have too many expenses. A budget will help you get a handle on your expenses. Take a little bit of your time and see where your money is going for a month. Suppose you took a couple a minutes a day and wrote down how much money you spent on what items. You would probably be shocked at what you spent when you add it all up at the end of the month. Now couldn't you have saved some of this? Sure you could.

The question most often asked is "How much money should I save?" A rule of thumb often given is 10 percent. What this means is that you should budget yourself as an expense. Ten percent of your paycheck should go first into your savings. You can decide how to allocate this into short-term savings versus long term savings. The difference between short-term savings and long term savings is that you don't touch long-term savings.

**A WORD TO THE WISE:** By not touching long term savings. You let compound interest work for you to build your wealth. As a wise person once said, "You work for your money so its only right to let your money work for you."

An excellent site for getting started with financial budgeting is

<http://www.edgate.com>

Click on "Practical Money Skills for Life".

Click on "For Teachers".

Click on "Lesson 3, Art of Budgeting".

Also see

<http://www.metlife.com/lifeadvice/money/docs/budgetintro.html>

In particular, click on "Monthly Expense Record" for a example of how to organize your expenses.

Also see DACOMP services site on household budget management

<http://www.dacomp.com/budget1.html>

Click on “Dick and Jane’s Sample Budget”.

You can access the National Foundation for Consumer Credit Counseling’s budget calculators at

<http://www.nfcc.org>

For financial planning using computer software see PC World’s

[http://www.pcworld.com/software/accounting\\_finance/articles/jan97/1501p134.html](http://www.pcworld.com/software/accounting_finance/articles/jan97/1501p134.html)

### **THINGS TO DO**

1. Determine how much you can save per month.
2. Decide whether you need to budget.
3. Determine if you need help for financial planning.
4. Track your expenses for a month.

### **LEARNING OBJECTIVE: HOW TO FIND HELP FOR FINANCIAL PLANNING**

If you are serious about financial planning, you can do it yourself or get someone to help you. There are programs such as Quicken that are useful or you can come up with your own system. Just do what works for you and is helpful (even fun) and not boring. At this point in your life, you probably will not need a professional planner, unless you are one of those e-commerce whizzes and have developed an on-going business with serious cash flow. If you are like most teenagers, then you can be your own financial planner. However, at some stage of your life when you have a good job, a nice income, planning a family, trying to build a house and worrying about retirement, you may need professional help.

For links to professional advice see the National Association of Personal Financial Planners

<http://www.napfa.org>

The world wide web is loaded with information on financial planning. For instance, simply entering the words “financial planning” in one search engine yielded 1,978,560 sites.

One of the more comprehensive sites is

<http://www.efmoody.com>

Click on “Financial Planning” then click on “Budget”.

**THINGS TO DO**

1. Try financial planning for a month.
2. Determine if it is for you.
3. Do you need help?
4. Go to the web for help.
5. Determine if you need professional help?
6. Find out if your parents are on a budget.
7. Do your parents have a financial plan?
8. Introduce them to planning on the web if they don't have a plan.

## **IV. MANAGING CASH AND SAVINGS**

### **LEARNING OBJECTIVES**

1. HOW TO MANAGE CHECKING ACCOUNTS
2. FINDING OUT WHAT TYPES OF SAVINGS ACCOUNTS EXIST
3. SELECTING A BANK

### **KEY TERMS**

1. CASH
2. CHECKING ACCOUNT
3. NOW ACCOUNT AND SHARE DRAFT ACCOUNT
4. ATM
5. DEBIT CARD
6. ELECTRONIC BANKING
7. STATEMENT SAVINGS
8. CDs
9. MONEY MARKET ACCOUNT
10. MONEY MARKET MUTUAL FUND
11. FEDERAL DEPOSIT INSURANCE CORPORATION

### **III. MANAGING YOUR CASH AND SAVINGS**

- A. CASH
  1. CHECKING ACCOUNTS
  2. ATMS
  3. DEBIT CARDS
- B. SAVINGS
  1. STATEMENT SAVINGS ACCOUNTS
  2. CDs
  3. MONEY MARKET ACCOUNTS
  4. MONEY MARKET MUTUAL FUNDS
- C. CHOOSING A BANK
  1. CONVENIENCE
  2. COSTS
  3. SERVICES

### **LEARNING OBJECTIVE: HOW TO MANAGE CHECKING ACCOUNTS**

Cash is defined as currency (dollar bills plus coins) and checking accounts. These are funds used primarily for transactions purposes. That is, you use cash to buy something. Credit cards are not considered as cash. Although credit cards are used to make purchases, the balances must be repaid with cash.

A checking account is a convenient way to make purchases. You don't have to carry around a lot of currency. However, a checking account requires a bit of maintenance. If you don't keep accurate records of the checks you write and how much you have in the account, you can overdraw your account and bounce

checks. This is not a good thing because most banks will hit you with a substantial penalty (like \$20 per bounced check). You should record how much money is in the account and deduct the amount of purchases and services charges.

**A WORD TO THE WISE:** You should attempt to minimize the amount of money you hold in your low interest or no interest checking account. If you have excess balances in your checking account at the end of the month, don't spend it, save it.

**THE CASE OF THE \$84 PIZZA!** You should avoid overdrawing the account. This is a true story. How would you like to pay \$84 for a pizza? A good friend's daughter had \$5 in her checking account and made a deposit using her bank's ATM on Friday night. She assumed that the deposit had been credited to her account. However, the bank posted the deposit on Monday. Meanwhile, on Saturday, she ordered a pizza for \$12 and tipped the delivery boy \$2 and paid by check. The check cleared before the deposit was posted and the check bounced. The bank charged her a fee of \$20. The check was returned to the pizza place which charged her \$20. The pizza place automatically sent the check to a collection agency which charged her \$30. Hence, the \$84 pizza!

A checking account typically earns no interest. However, there are checking-type accounts that do earn interest. These accounts are called a now accounts (negotiable order of withdrawal) or share draft accounts at a credit union. ATMs (automated teller machines) are a convenient way to withdraw cash from your checking account and make deposits. Just don't forget our pizza buying friend. Know when deposits at the ATM are posted to your account. Many ATMs charge a fee for withdrawal (usually not at your bank). You should deduct the ATM fee from your checking account balance.

**A WORD TO THE WISE:** If your bank charges you an ATM fee you may want to consider switching banks.

A debit card is an extension of your checking account. When you use it, the money is automatically withdrawn from your checking account. An advantage of a debit card is that you do not have to worry about bouncing a check. Another advantage is that some merchants who will not take a check will honor a debit card, since there is no fear of insufficient funds in your account. When you use a debt card, you should deduct the money from your checking account balance. If you don't you will increase the danger of writing a bad check (just remember that \$84 pizza!). Many banks also allow you to pay your bills from your computer instead of writing a check. This "electronic bill payer" is convenient. You don't have to write checks. You don't have to buy stamps. You don't have to say "the check's in the mail".

**ANOTHER WORD TO THE WISE:** Avoid bouncing checks! If you bounce checks and are slow to repay the bank, some banks will close your account and may prevent you from opening another checking account at most other banks for five years! Your delinquency gets reported to a company called ChexSystems which is a national database subscribed to by over 80 percent of the banks in the country. When you apply for a checking account at a bank, the bank checks with ChexSystems and if you are in their database, your application is denied.

There are two websites that give information on ChexSystems and what do you if you are denied an account. They are

<http://members.tripod.com/~CHEXSYSTEMSBITES/index.html>

and

<http://www.geocities.com/chexsystems>

For information on checking account and ATM fees go to

<http://www.bankrate.com>

Another good site is ZDTV'S

<http://www.zdnet.com/zdtv/moneymachine/personalfinance>

A great way to lower new check charges is to purchase the checks directly yourself. Go to

<http://www.checksinthemail.com>

or to

<http://www.checksunlimited.com>

### **THINGS TO DO**

1. If you have a checking account, find out if the balance that you have recorded is accurate.
2. Find out what your bank charges for your checking account.
3. Can you lower the charges by moving to a different type of account or a different bank?

## **LEARNING OBJECTIVE: FINDING OUT WHAT TYPES OF SAVINGS ACCOUNTS EXIST**

There are many types of savings accounts. A *statement savings* account is one at your financial institution that you open if you just request a “savings account”. It generally pays the lowest interest rate - often referred to as the “passbook rate”. This account is called a statement account because your checking account and savings account balances typically are given on your monthly bank statement. The statement account should be considered as your short term savings because it pays the lowest interest rate.

If you are saving for longer-term purposes then the remaining savings accounts are useful. A *CD* is a certificate of deposit. A CD is a savings account with a specific maturity date that pays a specified interest return. If you withdraw your money prior to maturity, you are usually assessed an early withdrawal penalty. A *money market account* is an account at a depository institution such as a bank, credit union or savings institution that generally pays a higher interest return than statement savings but a lower return than a CD. You have access to your money by writing checks *but the number of withdrawals per month are limited*. Consequently, these accounts are not used for transactions purposes. Money market mutual funds allow you to save by placing your money with professional investors who then buy short term securities. Money market accounts are not federally insured.

For rates on these savings accounts go to

<http://www.bankrate.com>

The Office of the Comptroller of the Currency in Washington, D. C. has an on-line brochure that discusses accounts that are federally insured by the Federal Deposit Insurance Corporation (FDIC) and those that are not federally insured.

<http://www.occ.treas.gov/depvsinv.htm>

### **THINGS TO DO**

1. Find out the different types of accounts offered by your bank.
2. What are the characteristics of these accounts?
3. Which one of these accounts makes sense for you?

## **LEARNING OBJECTIVE: SELECTING A BANK**

Most people choose their bank due to convenience. It is either convenient to where they live or work or both. Thus, these people are not as concerned with the costs of the services provided by the bank. They may not even inquire as to what services are offered by the bank, knowing that the bank should offer most services.

Although most people choose their bank because of convenience, if you do shop around you should ask your bank several questions such as

1. Do you pay interest on checking?
2. Is there a minimum balance?
3. Is there a charge for new checks?
4. Do you have overdraft protection for insufficient funds?
5. How much is the bounced fee charge?
6. Do you return canceled checks?
7. Do you have free checking?
8. Do you charge for ATM use?
9. What are your rates on statement savings, CDs and money market accounts?
10. If I have a savings account, do I get free checking?

Your bank is governed by a complex set of regulations. To see some of the regulations go to

<http://www.federalreserve.gov>

Click on "Regulation and Supervision".  
Click on "Regulations".

**A WORD TO THE WISE:** Many banks advertise "free" checking but require a minimum balance. This means that the account is not really free. Also, if you drop below the minimum balances, many banks will impose a penalty on you. Find out if "free" means "free".

Individual bank sites to visit are can be found at

<http://www.mybank.com>

If you think that you would like to bank online see

<http://www.Gomez.com>

**A WORD TO THE WISE:** Shop. Shop. Shop. Look for the best deals. Look for the lowest fees. Look for the best rates. Look for the best services.

An excellent site for shopping for financial services (mortgages, credit cards, savings instruments and consumer loans) is

<http://www.getsmart.com>

For an in-depth look at banking services, go to

<http://www.edgate.com>

Click on “Practical Money Skills for Life”.

Click on “For Teachers”.

Click on “Lesson 6, Banking Services”.

### **THINGS TO DO**

1. See if your financial institution has a website.
2. Find another financial institution that has a convenient location. Go to its website.
3. Compare the services of the two institutions.
4. See if these websites give the costs of the institutions' services.
5. See if these websites give the interest rates paid for savings.
6. Go to the website of an on-line bank.
7. How do the services and fees of the on-line bank compare with your bank?

## **V. MANAGING CREDIT**

### **LEARNING OBJECTIVES**

1. TO UNDERSTAND THE IMPORTANCE OF GOOD CREDIT
2. HOW TO ESTABLISH CREDIT
3. HOW TO MANAGE YOUR CREDIT
4. TO FIND OUT WHAT HAPPENS IF YOU FALL OFF THE FINANCIAL EDGE
5. TO UNDERSTAND THE FUNCTION OF CREDIT BUREAUS

### **KEY TERMS**

1. CREDIT
2. DEBT
3. BORROWING TOO MUCH
4. CREDIT COUNSELING
5. BANKRUPTCY
6. CHAPTER 7
7. CHAPTER 13
8. CREDIT REPORT
9. CREDIT BUREAU
10. CREDIT SCORING

### **IV. MANAGING CREDIT**

- A. BUY NOW AND PAY LATER
- B. HOW DO YOU ESTABLISH CREDIT
- C. STRATEGIES FOR MANAGING YOUR CREDIT
- D. THE PERILS OF BANKRUPTCY
- E. CREDIT BUREAUS
  1. CREDIT EVALUATION
  2. CREDIT SCORING

### **LEARNING OBJECTIVE: WHY HAVE GOOD CREDIT?**

Having credit allows you to “buy now and pay later.” However, there is a temptation to borrow too much and borrowing too much actually makes you worse off. People want stuff now, not later. But by buying now and going into debt, you make yourself poorer in the future. If you borrow too much, you actually reduce your standard of living now. This is not to say that you should not borrow. But you should not borrow too much. What is meant by “borrowing too much?” It is defined as being able to pay your bills when due but that’s all. This means that you are paying the minimum due on your credit cards and on your installment debt. You are able to pay the rent, the telephone bill, and the utilities. However, you have little if any money left and find yourself living from paycheck to paycheck while wondering “how did I get into this mess?” Well, by borrowing too much now, you have sacrificed future consumption.

By borrowing too much now you are now living on the financial edge. You are now vulnerable to bad things happening to you. If there is an emergency like an accident and you don't have insurance, how are you going to pay the doctor and your other creditors? If an emergency happens and you are living on the financial edge, you have no cushion so you fall behind on your payments. This messes up your credit and having good credit is important in today's society.

Having good credit greatly facilitates financial wellbeing. An immediate benefit is that with good credit you can borrow at lower interest rates than people with bad credit. The reason is that good credit means less risk to the lender than people with poor credit. So why mess up your credit? If you do you will end up paying more for the same goods, you will ultimately end up with less goods. This means that having poor credit will make you worse off. This is a bad thing but it will be your own fault.

Suppose you wanted to buy a car that costs \$12,000. Let us suppose that because you have good credit you will be charged 10 percent for financing the car for 48 months. If you put \$1,000 down your monthly payment will be \$279. At the end of 48 months, you will have paid \$2,391 in interest. What if you had lousy credit because you had paid your bills consistently late (and lenders hate slow payers). It is not an exaggeration to assume that you will have an interest rate of 20 percent. That means that financing the same \$11,000 for 48 months will cost you \$335 per month. You will pay \$5,067 in interest. You have just thrown away \$2,676.

If you want to see how different interest rates will affect your monthly payment go to

<http://www.fool.com/calcs/calculators.htm>

The relevant question here is why do you want to make yourself poorer by \$2,676? This is the cost of having bad credit. Well if you have bad credit, every time you borrow it will cost you more than if you have good credit. This is because if you are a poor risk. You are high maintenance to the lender. Your account costs the lender more to monitor and maintain than if you were a good credit. Since you cost the lender more, you get charged more. Therefore, it is your choice: manage your credit responsibly and pay less or lose control of your finances and pay a lot more.

**A WORD TO THE WISE:** Having good credit means that when you borrow you will pay less for credit. This means that you will have more money to spend on other stuff.

## **LEARNING OBJECTIVE: HOW TO ESTABLISH CREDIT**

Establishing credit is fairly easy to do. First, open up a checking account at a financial institution. Manage that account wisely. Have no or very few bounced checks. Open up a savings account at the financial institution. Then you can borrow with the amount secured by your savings balance. This secured loan will be at a low interest rate since the institution will have very little risk associated with the loan and allows you to establish a credit record. Once you have established a credit record, then apply for a credit card. Some credit unions will even let you have a credit card secured by your savings.

## **LEARNING OBJECTIVE: HOW TO MANAGE YOUR CREDIT**

Managing credit requires discipline. It is good to get in the habit of being disciplined with your finances. Here are some useful tips.

1. Credit is managed by controlling spending. This may mean adhering to a budget or following guidelines such as always save first, don't overextend yourself and don't live on the financial edge.
2. To control spending one strategy is to reduce the number of credit cards you have and don't max out the ones you keep.
3. If you are carrying a balance, then overpay the minimum payment.
4. When you pay off the balance, tear up the card and double the payment on the payment due of another card.
5. Reduce impulse buying. Leave your credit cards and checkbook at home.
6. Move your credit card balances to a lower interest rate card and limit cash advances.

For other information about credit, go to

<http://www.edgate.com>

Click on "Practical Money Skills for Life".

Click on "For Teachers".

Click on "Lesson 7, About Credit".

## **LEARNING OBJECTIVE: TO FIND OUT WHAT HAPPENS IF YOU FALL OFF THE FINANCIAL EDGE**

What happens to you when you fall off the financial edge? If you have a catastrophic illness and can't pay the medical bills, what happens? If you become unemployed and can't pay your bills, what happens? Well what happens is that your credit goes down the drain. Your creditors want to be paid and you will start getting calls and letters from them seeking to collect your bad debts now.

What should you do? First and foremost you should avoid the siren calls of bankruptcy. There are attorneys and others who are out there urging people to declare bankruptcy. Don't listen to them. This is how they make their living. They are more interested in adding to their income than helping you. Instead, get into debt management and budget counseling. These are usually a no cost service and many are available online. These counselors will try to help you negotiate with your creditors and to help you get back your good credit standing. Creditors want to be paid and will often allow you to pay them less per month or even defer payments. A credit counselor can help make this happen.

**A WORD TO THE WISE:** Only declare bankruptcy if the credit counselor tells you that you have no other alternative.

For information on what to do if you can't pay your bills, go to

<http://www.edgate.com>

Click on "Practical Money Skills for Life".

Click on "For Teachers".

Click on "Lesson 13, In Trouble".

The Consumer Credit Counseling Service provides debt management and budget counseling at

<http://www.cccsintl.org>

The National Foundation for Credit Counseling has an online debt counseling service at

<http://www.nfcc.org>

and by Debt Counselors of America at

<http://www.dca.org>

Also see the Center for Debt Management's site

<http://www.Center4DebtManagement.com/>

**A WORD TO THE WISE:** If you get in trouble, don't be too proud to ask for professional help.

## **LEARNING OBJECTIVE: TO UNDERSTAND WHAT BANKRUPTCY IS AND ITS CONSEQUENCES**

What about bankruptcy? Bankruptcy is truly a last gasp, no alternative route to take. It commonly takes two forms: Chapter 7 and Chapter 13. Under Chapter 7, all your debts are legally forgiven (that is you don't have to pay your creditors) and you have to sell most of your assets. This is really a bad thing. In essence you are saying "I have been irresponsible and those of you foolish to have loaned me money are going to have to pay for it." Under Chapter 13, the bankruptcy court administers a plan to pay your creditors some or all of what you owe over a period of time (usually three to five years). You keep your assets. Thus, if you have to file bankruptcy, file Chapter 13. That way, creditors will know that you did not try to walk away from your obligations and are making an effort to repay your debts.

When you declare bankruptcy, it appears on your credit report and stays there for *10 years*. When you then apply for credit, creditors will see the bankruptcy on your credit report. Many lenders have a policy of not granting credit if there is a bankruptcy on the credit report. Other lenders will put you in the worse risk category and will charge you a much higher interest rate. You have shown from previous actions that you are a risky bet for the lender. In order to get credit you must compensate the lender for taking the additional risk to lend to you. You will pay more.

**A WORD TO THE WISE:** Avoid bankruptcy! If you have no choice, and only on the advice of a professional debt counselor, file for bankruptcy. Then file under Chapter 13 not Chapter 7.

## **LEARNING OBJECTIVE: TO UNDERSTAND THE FUNCTION OF CREDIT BUREAUS**

The function of credit bureaus is to provide information to lenders on consumers' credit histories. The information comes from lenders where you have borrowed and from public court records (bankruptcies, liens and judgments). The information shows your credit history. How you have paid your debts is recorded. The result is the credit report which is available to lenders when consumers seek to borrow. The credit report contains the credit history but it also shows the accounts you have opened, closed and are currently open. The credit report is generally broken down into your retail credit history (credit cards), your installment credit history (auto loans) and your mortgage history. It also contains your payment history (amount owed, the number of times you have made late payments and the length of the delinquency). It also shows the number of times lenders have asked the credit bureau for information about you.

Because of the importance of your credit report to the lender in reaching a decision about your creditworthiness, it is important that your credit report is accurate. Don't be shy. Accuracy is important and statistics show that there are errors on *half* of all the credit reports. So the odds are pretty good that there will be an error on yours.

There is a website where you can get a copy of your credit report. Go to

<http://www.freecreditreport.com>

You can also request a copy of your credit report from your local credit bureau but generally you have to pay a nominal fee. It is important that you check your credit report for errors. This is especially important if you are turned down for credit. If you do get turned down, the lender is required to tell you the reason. If the reason is poor credit and you think you have good credit, then get a copy of your credit report and see if it is accurate. If you are denied, the copy of the credit report is free.

To see what a credit report looks like go to the credit report section in the National Foundation for Consumer Credit Counseling's

<http://www.nfcc.org>

**A WORD TO THE WISE:** Check you credit report! There have been cases where individuals have been denied credit and found that their credit report was not their own. Rather, another borrower's credit history was erroneously on the report.

There are three principal credit reporting agencies

Equifax

<http://www.equifax.com>

Experian

<http://www.experian.com>

Trans Union

<http://www.transunion.com>

These agencies take the information on your credit report and compute a credit score. The credit score is a summary of the information on the credit report. When you apply for credit, the lender contacts one of the three national credit reporting agencies to obtain a copy of your credit report. They look at the credit

score among other factors. Many lenders will rely only on the credit bureau's score. Others will score your application using their own internal rules. Then, given a predetermined set of guidelines, they will either accept or reject your application. Credit scoring is widely used and is increasingly important in the granting of credit. This is a direct byproduct of information technology, competition among borrowers and the need to make decisions quickly. The credit score allows a lender to make an accept or reject decision in only a few minutes.

In some cases, a borrower will be marginal. A lender with sometimes tell the borrower what must be done in order to get the loan. Often this involves strengthening the credit report. You may be asked to pay off some debts, reduce some balances, write a letter explaining a judgment or a lien against you or take some other action. So if you get turned down for credit, ask the lender what can you do in order to get an approval.

**THINGS TO DO:**

1. If you haven't established credit, do so.
2. If you have credit, determine if you have borrowed too much.
3. See if you are living on the financial edge.
4. Get a copy of your credit report.
5. Check it for accuracy.
6. Evaluate your own credit – is it good or bad?
7. Be honest with yourself: If you were applying for a loan would you lend to yourself?

## VI. CREDIT CARDS

### LEARNING OBJECTIVES

1. TO FIND OUT WHAT YOU KNOW ABOUT YOUR OWN CREDIT CARD
2. TO SEE WHAT TYPES OF CREDIT CARDS ARE OUT THERE
3. TO UNDERSTAND THE CHARACTERISTICS OF CREDIT CARDS
4. TO UNDERSTAND THE PROS AND CONS OF CREDIT CARDS
5. TO LEARN WHAT TO DO IF YOUR CARD IS LOST OR STOLEN
6. TO UNDERSTAND WHAT YOU SHOULD KNOW ABOUT SHOPPING ON THE INTERNET

### KEY TERMS

1. APR
2. MINIMUM BALANCE
3. BANK CARD
4. TRAVEL AND ENTERTAINMENT CARD
5. SINGLE MERCHANT CARD
6. GRACE PERIOD
7. ANNUAL FEE
8. SPECIAL INTRODUCTORY RATE
9. PIN NUMBER

- V. CREDIT CARDS
  - A. TYPES OF CREDIT CARDS
    1. BANK CARDS
    2. TRAVEL AND ENTERTAINMENT CARDS
    3. SINGLE MERCHANT CARDS
  - B. INTEREST CHARGES
  - C. ANNUAL FEES
  - D. THE PROS AND CONS OF CREDIT CARDS

We Americans love credit cards. In 1999, we charged over \$400 billion on our cards. We also paid \$50 billion in finance charges. The average household carried a balance of \$5,800. Interest charges averaged 18% and around \$930 in interest was paid (from the Motley Fool's <http://www.fool.com> Personal Finance, "Getting out of debt").

### LEARNING OBJECTIVE: TO FIND OUT WHAT YOU KNOW ABOUT YOUR OWN CREDIT CARD

Do you have a credit card? If you do, you should know the answers to the following questions.

1. What is the interest rate?
2. Do you have an outstanding balance?
3. What is the minimum amount that you have to pay per month?

4. How much in interest do you generally pay per year (look at the December statement)?
5. Do you use your card to get a cash advance?
6. Is the interest charge on the cash advance the same as the interest charge on purchases?
7. Do you pay an annual fee? How much is it?
8. Do you have to pay a late fee if you don't pay on time?

**A WORD TO THE WISE:** If you don't know the answers to these questions, then find out. An informed consumer is a wise consumer. An uninformed customer is a dumb one.

### **LEARNING OBJECTIVE: TO SEE WHAT TYPES OF CREDIT CARDS ARE OUT THERE**

There are many types of credit cards. You may have a *bank card*. This is a card like a VISA card. The issuer could be a bank, a savings bank or a credit union. You apply at the financial institution for the card and it has the financial institution's name on it. The great thing about a bank card is that you can use it all over the world. You can also use it in the case of an emergency. Suppose you had car trouble while on vacation. The people who tow your car and the people who fix it may not want to take your check and you may not have enough cash. But not to worry! You have a VISA! These cards allow you to carry balances over from month to month.

You could have what is called a *travel and entertainment card*. These cards are used just like bank cards. The difference is that generally you must pay off the entire amount charged when you receive the bill. Also, these cards typically have more stringent credit standards than do bank cards and charge a pretty high annual fee.

You could have a *single merchant card* (or retail card). This could be a gasoline card or a card from a particular retailer (like a department store). Usually, your bank card can be used to make purchases at the gasoline station and at the retailer. So why have both cards? That's a good question. The choice is up to you. However, many people like to keep their purchases separated so they can easily see how much they are spending per month on gas or at a particular merchant.

**A WORD TO THE WISE:** Once you get your credit card, pay off your purchases every month. Its like getting an interest free loan for 30 days.

**ANOTHER WORD TO THE WISE:** Try to pay more than the minimum that these cards bill you each month. Be careful not to overextend yourself.

## LEARNING OBJECTIVE: TO UNDERSTAND THE CHARACTERISTICS OF CREDIT CARDS

Now its time for the boring stuff – but stuff you should know.

**APR:** Credit card companies will charge you interest if you carry over balances. This interest is called the APR (annual percentage rate). All creditors must tell what the APR is. This is your cost of credit. You will be told if the APR is fixed or variable. Fixed means that if it is 12 percent, then it will not change. The issuer may later change it however, depending on economic conditions. That is, if interest rates in general keep rising and rising, the issuer may inform you that your APR will increase. Usually this will apply only to future purchases and your old purchases will remain at the old rate. Variable means that your interest rate is subject to change. A common way is to link your rate to the prime rate – like prime plus 5 percent. So whatever the prime rate is, your rate will be 5 percent more.

How does the APR work? Suppose your APR is 18 percent. That is 1 1/2 percent per month. If you go out a charge \$1,000, then at the end of the month you will get a bill. You can either pay off the entire amount or the minimum balance. Lets assume that the minimum balance is 2 percent (\$20). If you pay the minimum, then 1 1/2 percent of the \$1,000 balance (\$15) will go toward paying the interest that you owe while the rest (\$5) will go toward lowering the principal. You now owe \$995. If you don't charge anything else, the next month you again owe 2 percent of the new balance (\$19.90). You pay the minimum and again 1 1/2 percent of the \$995 balance (\$14.93) goes to pay of the interest and \$4.97 goes to reduce the principal. You now owe \$990.03. Note that compared to the first month, you paid a bit more in principal and a bit less in interest. This continues until most of your payments go to principal and less to interest. But get the picture? At this rate you are never going to pay off the balance. After *100 years* you will still owe \$2.45 and would have paid \$2,992.67 in interest in addition to the principal of \$997.55.

**GRACE PERIOD:** For most cards, there is a *grace period*. This means that if you pay your balance before the due date on the bill, you won't have to pay a finance charge. But be vigilant! Some issuers don't have a grace period. This means that even if you pay off your balance before the due date, you still get hit with a finance charge based on either the average daily balance or the monthly balance.

**A WORD TO THE WISE:** There is enough competition out there for you to look for a card that gives you a grace period.

**ANOTHER WORD TO THE WISE:** Want to pay off your balances and don't have enough money right now? Then always pay more than the minimum payment due.

**ANNUAL FEE:** Some cards assess an annual fee. Others don't. An annual fee has the effect of raising the interest rate charged by the issuer.

**A WORD TO THE WISE:** Again there is enough competition out there to shop for the best deal including finding a card without an annual fee or at least one with the lowest annual fee.

**SPECIAL INTRODUCTORY RATES:** Many cards offer a special low introductory rate. This is good for a short period of time – like 6 months and then the regular rate kicks in. The regular rate could be fixed or variable. However, for certain it will be higher than the introductory rate. When the regular rate starts, all new purchases will be accessed at the new rate. One advantage of the special rate is that often the card issuer will let you transfer your old credit card balances which are at a higher rate to the new card at the special rate. Then you will be paying less interest charges on those balances.

What are the effects of these rates? Is it better to have a card with a low introductory rate and an annual fee than a card with no introductory rate and no annual fee? What about a card with a low introductory rate and an annual fee versus one with no introductory rate and an annual fee? Or how about one with a low introductory rate and no annual fee? Trying to figure all this out gets pretty confusing real fast. Fortunately, there are financial calculators that can do the work for you.

**THINGS TO DO:** Go to the Motley Fool's

<http://www.fool.com>

Click on "Personal Finance". Click "calculators". Click on "Is a lower rate worth the annual fee." Look at the results of their example. Now fill in your own numbers to see which card would be the best for you.

**A WORD TO THE WISE:** Make certain that you are not charged a transfer fee if you transfer balances from one card to another. Many times these fees negate the lower interest rates on the new card.

**ANOTHER WORD TO THE WISE:** Don't be so blinded by a low initial fee that you forget to read the small print about the annual fee, the grace period and the regular interest rate.

**CASH TRANSFERS:** Many cards will allow you to make cash transfers at ATM machines. The rates charged for this service are very high and cannot be avoided. They are assessed once you withdraw the funds. Therefore, you cannot avoid the fees by paying within the grace period. In order to be able to transfer funds, you will select a PIN (personal identification number). If you write down

the number, don't keep it with your credit card. If you lose your wallet or if it is stolen, you don't want thieves to have access to your card *and* PIN.

**A WORD TO THE WISE:** When you choose your pin, avoid selecting obvious numbers such as your birthday, phone number or the last four digits of your social security number.

**ANOTHER WORD TO THE WISE:** The only reason you need a PIN is for cash transfers. Since this is an extremely expensive way of borrowing, use it only as a last resort. Check to see if it is cheaper to get cash using your ATM card.

### **LEARNING OBJECTIVE: TO UNDERSTAND THE PROS AND CONS OF CREDIT CARDS**

**THE PROS:** Credit cards are great! And in today's world credit cards are almost a necessity.

1. If you buy stuff on the web, you need a credit card (but make sure they have a secure server).
2. If you rent a car, you need a credit card.
3. If you make hotel reservations, you need a credit card.
4. If you make airline reservations, you need a credit card.
5. Credit cards are convenient – you don't have to lug around a lot of cash.
6. You get a statement every month of what you bought so you can see where (some of) your money went.
7. Some credit cards will give you points toward gifts and airline tickets.
8. Some will even give you a rebate.
9. Credit cards even provide protection against theft. If you report your card stolen, you will not be liable for charges that you did not incur.

**THE CONS:** The dark side:

1. You can yield to the temptation of more, more, more and overextend yourself. Don't be on the financial edge.
2. Credit cards are a very expensive way of borrowing. You will find that most rates are in the double digits. Think you can find a savings account that pays those kind of rates?
3. Remember you are giving up future consumption. Don't forget that buying more today means that you are going to buy less tomorrow.

## **LEARNING OBJECTIVE: TO LEARN WHAT TO DO IF YOUR CARD IS LOST OR STOLEN**

Once you get your statement, check it carefully. Make certain that all the purchases are yours. If there is an error, do not pay the item in question. Instead, call the card issuer and tell them of the error. When an item is in dispute, you will not be reported to the credit bureau as delinquent on your payment.

Visa has a zero liability policy for all VISA cards issued in the U.S. This offers you protection against unauthorized Visa card usage. It guarantees you maximum protection against fraud. You now have complete liability protection for all of your card transactions that take place on the Visa system. Should someone steal your card number, you are protected if they try to rip you off by shopping, online or off. You're protected - you pay nothing for their fraudulent activity.

For more information go to

[http://www-s2.visa.com/av/zero\\_liability/faq.html](http://www-s2.visa.com/av/zero_liability/faq.html)

**A WORD TO THE WISE:** If when you charge with your credit card, see if the merchant's copy has a carbon with it. If so, tear up the carbon into tiny pieces. Some bad guys fish the carbons out of the trash and then they have a copy of your card number, the expiration date, *and* your signature. The next thing you know, you'll be seeing charges that were not yours on your next statement. Also, if you throw away your receipts, shred them first to protect yourself against theft and loss.

**ANOTHER WORD TO THE WISE:** Shred any unsolicited pre-approved credit card applications that you might get in the mail. If you don't someone may dig the application out of the trash, get the card and since your name will be on it, use it causing you temporary grief.

For additional information on credit cards, see

<http://www.edgate.com>

Click on "Practical Money Skills for Life".

Click on "For Teachers".

Click on "Lesson 8, Credit Cards".

Keep these basic principles in mind.

1. If you have credit cards, then use credit cards as a short-term loan and repay balances monthly.
2. It is important to establish good credit and you do so by paying off your balances and not being late in your payments.
3. When you later need good credit to buy cars and a house, you will be able to borrow at lower rates than if you have poor credit.
4. Saving each month and letting your money accumulate through the wonders of compound interest will make you wealthy and financially independent.
5. Each month pay yourself first.

### **LEARNING OBJECTIVE: TO UNDERSTAND WHAT YOU SHOULD KNOW ABOUT SHOPPING ON THE INTERNET**

Using your credit card to shop on the internet is fun. It is easy. It is convenient. Sometimes its cheaper than going to the store. Many internet stores offer considerable discounts, don't charge for shipping and don't charge sales taxes. Here are some things to keep in mind:

1. Shop with reputable retailers.
2. Make certain that you are clear about delivery costs and return policies.
3. Always use a secure server (many internet service providers will flash a message on the screen telling you if the server is not secure).
4. Keep a record of your transactions.

### **THINGS TO DO**

1. Next time you receive a credit card solicitation in the mail. See
  - a. is there an introductory rate?
  - b. what is the regular rate?
  - c. is there an annual fee?
  - d. is there a transfer fee?
2. If you already have a credit card, look at your statement
  - a. what does the small print say?
  - b. what is your credit limit?
  - c. how much is your balance?
  - d. do you have a plan to pay it off?
3. Share your newfound knowledge about credit cards with your friends, your relatives and your teachers.

## VII. CONSUMER LOANS

### LEARNING OBJECTIVES

1. TO FIND OUT WHAT TYPES OF CONSUMER LOANS ARE THERE.
2. TO UNDERSTAND THE BEST WAY OF BUYING A CAR
3. TO UNDERSTAND WHY AUTO INSURANCE IS IMPORTANT
4. TO UNDERSTAND HOW TO BUY A HOUSE
5. TO UNDERSTAND THE IMPORTANCE OF HOMEOWNER'S INSURANCE

### KEY TERMS

1. REVOLVING CREDIT
2. INSTALLMENT LOAN
3. SECURED LOAN
4. UNSECURED LOAN
5. LIABILITY INSURANCE
6. FIXED RATE MORTGAGE
7. ADJUSTABLE RATE MORTGAGE
8. FHA-VA MORTGAGE
9. PROPERTY INSURANCE
10. BASIC COVERAGE POLICY
11. BROAD COVERAGE POLICY

- VI. CONSUMER LOANS
  - A. REVOLVING CREDIT
  - B. INSTALLMENT LOANS
  - C. SECURED VS UNSECURED LOANS
  - D. INTEREST RATES ON LOANS
  - E. BIG TICKET ITEMS: AUTOMOBILES AND HOUSING
    1. HOW TO BUY A CAR
      - A. INFORMATION SOURCES
      - B. SHOPPING FOR THE BEST DEAL
      - C. FINANCING
      - D. INSURANCE
    2. HOUSING: PURCHASING VS RENTING
      - A. LOOKING FOR HOUSING
      - B. DOING YOUR HOMEWORK
      - C. GUIDELINES FOR RENTING
      - D. GUIDELINES FOR PURCHASING
      - E. FINANCING
      - F. TYPES OF MORTGAGES AND INTEREST RATES
      - G. INSURANCE

## **LEARNING OBJECTIVE: TO FIND OUT WHAT TYPES OF CONSUMER LOANS ARE THERE**

There are several types of consumer loans. Credit cards are generally considered as *revolving credit*. This is the type of loan in which balances are carried over from one period to the next and an interest charge is assessed against the outstanding balance.

There are *installment loans*. These are loans in which the balance is paid off over a certain period of time and the interest rate can be either fixed or variable. Installment loans are for long term nonresidential purposes, and is second only to mortgage debt in the United States. With installment loans, the debt is repaid in roughly equal payments over time. You may borrow to furnish your apartment or house in this manner. The amount that you pay monthly will retire the interest and the principal of the loan by the last payment.

A loan can be secured or unsecured. A *secured loan* is one in which the lender has a claim on the asset. This means that if you buy a car and can't make the payments, the lender can repossess the car. An *unsecured loan* has no collateral. Generally, these loans are smaller than secured loans and most unsecured loans have higher interest rates than secured loans.

Interest rates on loans are disclosed under the Truth In Lending Act and are required to be the annual percentage rate (APR). This is the annual percent of interest charged on the loan. The lender is required to disclose all the finance charges associated with the loan which are then converted into the APR.

For information on consumer loans see

<http://www.getsmart.com>

## **LEARNING OBJECTIVE: TO UNDERSTAND THE BEST WAY OF BUYING A CAR**

### **BIG TICKET ITEMS: BUYING A CAR**

Do you want to buy a car? OK. First, let's assume that you have done your financial planning and can buy the car without putting yourself on the financial edge. There are various sources giving information on new cars. Most buyers know that there is a dealer sticker price that is seldom paid by customers except in the cases of automobiles with high demand. If you want to buy these cars, then you may end up paying *over* the sticker price. New and used car information can be obtained by consulting sources such as the NADA book available at most financial institutions and at most libraries. In addition, the NADA book is available on the web.

For a guide to automobiles see

<http://www.caranddriver.com> Go to Buyers Guide

<http://www.autos.yahoo.com>

For information on new and used automobiles see

<http://www.nada.com>

<http://www.autos.yahoo.com/edmunds>

<http://www.classifieds.yahoo.com>

You can even buy at car online at

<http://www.excite.com/autos/>

also see

<http://www.giggo.com>

Now that you have all this information, what are you going to do with it? For many people, an automobile is an impulse purchase. This is a bad thing! An automobile purchase is serious business and should be approached with deliberation rather than haste. So you see a great little coupe on Big Bob's Used Car Lot and you just have to have it. Slow down. There are plenty of cars out there. First things first.

**A WORD TO THE WISE:** Don't go to the lot and drive the car before you do your homework.

Ask yourself these questions:

1. Do I really need a car?
2. How much does a car really cost?
3. What is the gas mileage?
4. How much for insurance?
5. How much for maintenance
6. How much for tags and title?
7. Can I afford it given my budget?
8. How do I know if it is a good car or a lemon?
9. Is it a safe car?
10. Should I buy a new car or a used car?
11. Should I lease?

There are guides to help you with these questions at

<http://www.edmunds.com>

<http://www.kiplinger.com/tools/>

and the Kelly Blue Book at

<http://www.kbb.com>

Note to motorcycle shoppers: The Kelly Blue Book also offers information on new and used motorcycles.

A step-by-step buyers guide is on the Motley Fool's Personal Finance website (Buying a car) at

<http://www.fool.com>

Is it a safe car? For information on automobile crash ratings go to

<http://www.nhtsa.dot.gov>

Armed with all this information, you should know

1. What type of car you are going to buy.
2. How much you can afford to spend.
3. What is the value of the car (if used).
4. What the dealer paid for the car (if new).

Now go test drive the car (or cars) and then negotiate!

**A WORD TO THE WISE:** You may not want to choose a car that is likely to get stolen.

For information on which cars are popular among thieves and vehicle safety ratings, see

<http://www.hwysafety.org>

Additional information on buying a car can be found at

<http://www.edgate.com>

Click on "Practical Money Skills for Life".  
Click on "For Teachers".  
Click on "Lesson 9, Cars and Loans".

## LEASING

The typical young person is not likely to lease. Leasing is generally for those who trade in cars often, who have good credit and who are financially stable. Nevertheless, if you want to explore the possibility of leasing, one of the best websites is

<http://www.lesetips.com>

Go to “The Truth about Leasing.”

Other valuable websites are

<http://www.aigdirect.com>

<http://www.leaseguide.com>

<http://www.cars.com>

The Better Business Bureau has a website “Tips on Short-term Vehicle Leasing” that is succinct and useful

<http://www.bbb.org/library/autolease.html>

So, should you lease or buy? It depends. Go to

<http://www.kiplinger.com/calc/>

Choose “spending calculator”. Scroll down to “Do I lease or purchase?” Fill in the numbers to see which is the best option for you.

**A WORD TO THE WISE:** Shop a leased vehicle just like you would shop for a new car purchase. Also shop the lease itself. You may be able to get a better deal.

## **LEARNING OBJECTIVE: TO UNDERSTAND WHY AUTO INSURANCE IS IMPORTANT**

What about insurance? You need insurance if you are going to own a car. Most states will require that you, at a minimum, carry liability insurance. Then if you are the cause of an accident, your insurance covers claims against you. Automobile policies also can provide coverage to repair your vehicle, provide protection if the other driver caused the accident and is not insured, and to cover medical bills. information on automobile insurance can be found at most insurance company websites.

If you own a car, you most likely have insured your car and are familiar with property and liability insurance. The companies that provide this insurance provide automobile insurance, homeowners insurance and rental insurance. They protect their customers against theft, automobile accidents, fires and other occurrences. Young people probably are aware that if they drive a car, they need to be protected against accidents. Not only do they need protection if they cause an accident, they need protection if they are involved in an accident that is someone else's fault. If you cause an accident, you need liability insurance coverage, which is mandatory in all states. Young people also most likely realize that their insurance policies cost more than do the policies of older drivers.

Automobile insurance information can be found at

<http://www.insuranceman.com/auto.htm>

and at

<http://www.kiplinger.com/insure/>

Insurance rates by states and advice on how to keep down the cost of automobile insurance is found in the Consumer Insurance Guide at

<http://www.insure.com>

What about costs? First, you should factor insurance costs into the cost of operating your vehicle. Being young, you can expect to pay among the highest rates for any insured class. This is because young people historically are higher risk drivers than the population as a whole. In addition to your age, your rates will depend on other factors such as the type of car you drive (sports cars are more expensive than sedans), size of the engine (the bigger, the more expensive the policy), what type of driving record you have (citations and accidents are a no-no) and where you live (some areas have higher rates of accidents and auto theft than others).

For information on types of policies and types of coverages and what questions you should ask, go to

<http://www.kiplinger.com/managing/insurance/auto/>

For comparisons of rates see

<http://www.insweb.com>

<http://www.esurance.com>

<http://www.youdecide.com>

Automobile insurance quotes are also found at the Quicken Insurance Center's

<http://www.carautospecials.com/auto/quickeninsurancecenter.htm>

**A WORD TO THE WISE:** You can't change how old you are but you can affect the cost of your auto insurance. Drive safely. Take a driver's ed course (some insurance companies will then give you a discount). See if you can get a discount if you are on your parent's policy.

**ANOTHER WORD TO THE WISE:** If you can't afford to buy auto insurance, you cannot afford to own a car. With over 30 million automobile accidents a year, its only a matter of time until you are involved in one.

## **BIG TICKET ITEMS: BUYING A HOUSE**

### **LEARNING OBJECTIVES: TO UNDERSTAND HOW TO BUY A HOUSE**

Home ownership may not seem relevant for teens. However, mortgage officers state that they are making more first mortgages to young people between 19 and 25. Teens may wish information on home ownership if they decide to work full time rather than go to college or if the option of home ownership exists when they do go to college.

Should you buy or rent? Essentially, this is similar to the decision on purchasing a car versus leasing. The financial calculators are similar.

Go to

<http://www.kiplinger.com/tools/>

Under "Spending" click on "Am I better off renting?"

If you decide that buying is for you, then the first thing you should do is seek the advice of a housing counselor. These professionals are often found at local agencies and provide their services at no cost. The counselors discuss items such as the down payment required, income to debt ratios, housing expense ratios and the credit report. They will also discuss how to shop for a home.

To find a housing counselor, go to

<http://www.hud.gov/buyhome.html>

Click on "Housing Counseling". Click on your state.

## **THE HOME SEARCH**

What to buy a house? First determine how much can you afford. This does not simply mean the house note. It also includes taxes and insurance. It includes utilities, landscaping and maintenance. Then, you must assess your tastes and preferences. An individual must decide how much house to buy and how much to spend. If the person is deciding between buying or renting, then a comparison should be made between the alternatives. This involves evaluating the tax advantage of home ownership. Second, a home may not mean a single detached dwelling but rather a mobile home, a condominium or another type of multifamily home.

You have to decide on questions such as

1. What is the best location?
2. Should I be close to work or to school?
3. Is public transportation close by?
4. How big should the house be?
5. Do I need a big yard?
6. Are there recreation facilities nearby?
7. What are the property taxes in this area?
8. Should I buy an older house or a new one?
9. How much is homeowners insurance?
10. What does an inspection cost?
11. Do I have to have flood insurance?
12. How much are utilities?

For more information on these and other questions, go to the Mortgage Bankers Association's website at

<http://www.mbaa.org>

Click on "Home Buying Tips".

Also see the Department of Housing and Urban Development's (HUD) Homebuyer's Kit at

<http://www.hud.gov/buyhome.html>

Click on "home buyer's information". Click on "100 Q & A about buying a home". Also click on "Tips for first-time homebuyers."

Should you use a real estate agent? The answer is yes, but not exclusively. Although you may call upon a real estate agent to help you find a house, more times than not you will see a sign in front of a house with a real estate agent's name on it. That agent is working for the seller and not the buyer (you). This does not mean that the agent will be less than truthful or will not try to get you a good deal. It means that you must be certain to ensure that your agent is also working in your interests as well. Many houses are listed in multiple listing services which are available on the web. This will also give you information about what types of housing is available in your price range.

For information on home ownership, see the websites of the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac).

<http://www.fanniemae.com>

<http://www.freddiemac.com>

## **THE APPLICATION PROCESS AND FINANCING**

The application process can be daunting. Lenders advertise rates in the newspaper and you can locate rates on-line. The application itself is long, involved and complicated. Although the lender will explain what is in the application, most people will forget most of the details. When you make a application, the lender will determine if you qualify for the mortgage and will perform a credit check. The lender will want to have the credit information to see how you have handled your credit in the past. You will be asked to provide financial statements, bank account balances and income tax returns so the lender can determine the size and stability of your income. The lender will ask for permission to verify information. An appraisal will be conducted of the property to evaluate collateral. The lender will also be interested in your employment stability (how long have you worked at your current job, how long have you worked in your current profession) and your residential stability. You will also provide your contingent exposure (credit card lines open), prospects for continuing employment and evidence of competent money management skills.

Competent money management means the importance of budgeting. A down payment of 5% - 20% is normally required to purchase a home. You should have saved this amount plus have enough in reserve for routine maintenance and for emergencies. Competent money management also means that you do not have too much debt relative to your income. Debt to income ratios of 45% or less are desirable as well as a housing ratio (house payment/gross income) of 36%. These must be accounted for in the budgeting process.

The lenders who finance mortgages can be local or national institutions. Banks, savings institutions and credit unions originate and service mortgage accounts. Mortgage banking institutions don't take deposits but also originate and service loans. They are the largest originators of FHA-VA loans and typically sell their loans to investors. Although many of these firms have local offices, most of the mortgage bankers also offer their services via 800 telephone numbers and on the world wide web.

**A WORD TO THE WISE:** Shop lenders. Shop rates. Find out what are the loan terms from various lenders. Bargain with the lenders for the best deal, just like you bargain with a car dealer for the best deal. Many times you can get a better rate than the one that is advertised.

For a list of questions to ask yourself and lenders about rates, go to

<http://www.pueblo.gsa.gov/housing.htm>

also go to

<http://www.kiplinger.com/tools/>

What are some financing alternatives to consider? Should you get an adjustable rate or a fixed rate mortgage? A fixed rate mortgage is one where the interest rate is set and does not change over the life of the loan. The advantage of a fixed rate mortgage is that it is simple to include in your financial plan. You know what the payment will be over the life of the mortgage. These payments can change slightly if your mortgage note includes payments for property taxes and insurance and these amounts change. A major advantage of a fixed rate mortgage is that as your income increases over the life of the mortgage, the proportion of your budget devoted to housing expense will fall. Also, the majority of your mortgage note early on will be interest payments, giving you a larger tax deduction.

An adjustable rate mortgage has an interest rate that may change over the life of the mortgage. These mortgages usually have lower initial interest rates than a comparable fixed rate mortgage, meaning lower monthly payments. This low interest will stay in place for a set period of time, like one year. Then the interest rate will adjust on a specified periodic basis such as every six months or once a

year and is tied to some interest rate index that is not controlled by the lender. The rates can adjust upward, if overall interest rates go up or downward, if overall interest rates move down. It may make sense to have an adjustable rate mortgage if you anticipate moving in a few years.

How do you decide which of the rates is best for you? HSH Associates' webpage has information on current mortgage rates in your state, a mortgage calculator and adjustable rate mortgage indexes.

<http://www.hsh.com>

see also

<http://www.getsmart.com>

The Federal Consumer Information Center has various consumer guides on purchasing a home, adjustable rate mortgages, buying a mobile home and shopping for the best mortgage.

<http://www.pueblo.gsa.gov/housing.htm>

There are also special mortgages for low to moderate income and first time buyers. Check with your lender about these mortgages. Also, get information on FHA (low-to-moderate income) mortgages at

<http://www.hud.gov/fha/fhaabout.html>

If you are a veteran or know a veteran, then you probably know that veterans can obtain a government home loan guaranty through the Veterans Administration.

<http://www.homeloans.va.gov>

You can learn more about buying a house at

<http://www.edgate.com>

Click on "Practical Money Skills for Life".

Click on "For Teachers".

Click on "Lesson 5, Buying a Home".

## **LESSON PLAN: TO UNDERSTAND THE IMPORTANCE OF HOMEOWNER'S INSURANCE**

There are several types of Insurance policies to consider. Some of the most common are

1. HO-1. This is referred to as "basic coverage". It provides protection against damage from fire, lightning, glass breakage, windstorm or hail, explosion, riot or civil commotion, aircraft, vehicles, smoke, vandalism, mischief and theft and provides protection to others injured on the property.
2. HO-2. This is "broad coverage". It adds to the HO-1 policy falling objects, weight of snow, ice and sleet, freezing and covers heating, plumbing, electrical and air conditioner systems.
3. HO-3. This covers all hazards except for flood, war, earthquake and nuclear attack.
4. HO-4. This is for renters.
5. HO-5. This is like HO-3 but covers all perils.
6. HO-6. This is for condominiums.
7. HO-8. This is for older homes whose cash value is below replacement costs.

For greater details on these policies, go to

<http://www.homestore.com/Finance/Insurance/Owner.asp>

**A WORD TO THE WISE:** Mobile homes can be more expensive to insure than site-built houses. See

<http://www.insure.com/home/mobilehome.html>

Insure.com lists several ways to save on homeowner's policies. Some of these are

1. Shop price.
2. Raise your deductible
  - a. raising to \$500 could save you up to 12%
  - b. raising to \$1,000 could save you up to 24%
  - c. raising to \$2,500 could save you up to 30%
  - d. raising to \$5,000 could save you up to 37%
3. Buy home and auto insurance from the same company.

4. Newer homes may have cheaper policies than older homes.
5. Insure the home and not the land.
6. Get an alarm system and smoke detectors.
7. Don't smoke. There are over 23,000 residential fires per year and some companies offer discounts to homeowners who have no smokers in the family.
8. Stay with the same insurer. Some companies offer discounts after you stay with them six years.
9. Review your policy every year to see if you need to add or delete some coverage.

For more details, see

<http://www.insure.com/home/savings.html>

**TO DO:** Go to <http://www.kiplinger.com/tools/>

1. Look under "Spending" click on "How much should I put down on a home?"
2. Click on "How much can I borrow?"
3. Click on "Which is better: fixed or adjustable?"
4. Click on "Which is better: 15 or 30 year term?"
5. Go to <http://www.edgate.com>
  - a. Click on "Practical Money Skills for Life"
  - b. Click on "For Teachers"
  - c. Click on "Lesson 5 Buying a Home"
  - d. Go to "Lesson Outline". Then
  - e. Go to "Teaching Notes".

## VIII. INVESTING

### LEARNING OBJECTIVES

1. TO UNDERSTAND THAT FOR THE INDIVIDUAL SAVING AND INVESTING ARE THE SAME THING
2. TO UNDERSTAND THE INVESTING ENVIRONMENT
3. TO LEARN ABOUT RISK AND RETURN
4. TO FIND OUT WHAT TYPES OF INVESTMENT INSTRUMENTS ARE OUT THERE

### KEY TERMS

1. RISK
2. EXCHANGE MARKET
3. THE MONEY MARKET
4. THE CAPITAL MARKET
5. PRIMARY MARKET
6. SECONDARY MARKET
7. FUTURES, FORWARD AND OPTION MARKETS
8. SEC
9. STOCKS
10. BONDS
11. MUTUAL FUNDS
12. DIVERSIFICATION

### VI. INVESTING

- A. WHAT IS INVESTING AND WHY IS IT IMPORTANT
- B. THE INVESTING ENVIRONMENT
- C. RISK AND RETURN
- D. TYPES OF INVESTMENTS
  1. CASH
  2. STOCKS
  3. BONDS
  4. MUTUAL FUNDS

### LEARNING OBJECTIVE: TO UNDERSTAND THAT FOR THE INDIVIDUAL SAVING AND INVESTING ARE THE SAME THING

Why do you want to invest? Investing is virtually the same as saving. Just like saving, when you invest, you want to increase your income flow and increase the value of your assets. That is you want to increase your wealth. Also, in investing like in saving, you are postponing consumption until the future. When you save, you consume less today. However, you will be able to consume much more in the future. This is the power of compound interest. In addition to the impact of savings on you personally, savings is extremely important from the standpoint of the economy. Savings are the source of funds for business investment which

allows for the economy to grow and prosper. For most people, saving is putting money into accounts at financial institutions such as banks and credit unions. Investing means putting money into stocks and bonds. However, there is no real difference in savings and investing. In both, you are deferring consumption by saving more today.

The interest rates paid on your savings (or investments) will depend on the health of the economy and/or the companies where your money is invested. For information on the national economy, see the websites of the Dismal Scientist and the Conference Board

<http://www.dismal.com>

<http://www.conference-board.org>

For information on particular companies, go to that company's website or to the website of a firm that follows industrial trends such as

<http://www.marketguide.com>

Financial Pipeline provides a review of current events in financial markets and also information on market strategies

<http://www.finpipe.com>

For websites on financial information see the Discovery Channel's

<http://www.school.discovery.com/schrockguide/business/finance.html>

Just like it is important to start saving today, it is also important to start investing or learning about investing. This will help you achieve your financial goals (more income, a better standard of living, college tuition, a home, automobiles and a comfortable retirement). Remember that just by saving \$125 a week at 6% from age 17 until age 65 in a tax deferred account, you will have \$1,676,886 when you reach age 65.

## **LEARNING OBJECTIVES: TO UNDERSTAND THE INVESTING ENVIRONMENT**

How do markets operate? Markets establish prices through the supply and demand for products. If there is too much supply relative to demand, then prices fall. If there is too much demand relative to supply, then prices rise. The fact that prices are rising does not mean that producers are trying to gouge consumers. It only means that demand is high relative to supply. If consumers resisted the price increase, they could stop buying the product or would buy less of it. Markets mobilize scarce resources and seek to do it efficiently in order to

minimize costs. Market participants are consumers and producers and include households, businesses and governments.

The markets that we are interested in here are called exchange markets. In these markets financial instruments are bought and sold.

These markets are divided into the following

1. The money market – this is the market for instruments that mature in less than one year. These are instruments such as Treasury bills and CDs.
2. The capital market – this is the market for instruments that mature in more than one year. These instruments include stocks, bonds and mortgages.
3. Primary market – this is the market where instruments are first issued.
4. Secondary market – the market where instruments that are already issued are bought and sold.
5. Futures markets – these are markets for instruments whose prices are negotiated today but will be delivered to the buyer at a future date.
6. Option markets trade puts (right to sell) and calls (right to buy) that give investors the right but not the obligation to execute contracts for specific assets at the contract's exercise price until the contract expires.

The contemporary environment influences the operations of financial markets. Regulation plays an important role. The Securities and Exchange Commission is the principal Federal regulator. It oversees the actions of brokers, dealers, investment advisors and mutual funds in addition to regulating the operations of the securities exchanges like NASDAQ and the New York Stock Exchange (SEC).

An important function of the SEC is in requiring the disclosure of financial information by firms who sell stock to the public. If you want to invest in a firm, you should know its financial situation and have access to relevant financial information. This disclosure will give you a better estimate of the risk of your investment and the return from it.

Unlike saving your money in a Federally insured account at a financial depository institution like a bank or a credit union, your investments in stocks and bonds are not protected by Federal insurance. There are no guarantees of return. In order to minimize the risk that you would take due to lack of information, the SEC requires certain disclosures and investigates companies for fraud. Through research and access to information, you can decide if a particular investment is worthwhile. Of course, you may be wrong. But then again, you may be right.

For information on the SEC go to

<http://www.sec.gov>

Click on “About the SEC”. Click on “The Investor’s Advocate”.

The National Association of Securities Dealers is a private regulatory organization for securities dealers. They establish guidelines for behavior of dealers. The NASD develops rules and regulations, conducts regulatory reviews of members’ business activities, disciplines violators, and designs, operates, and regulates securities markets and services to benefit and protect the investor.

For more information on the NASD go to

<http://www.nasd.com>

Financial markets are organized into several markets. There are the exchange markets. These could be local, regional and/or national. Some also allow for global trading. The common types of exchange markets are the auction market and the over the counter market. The auction market is a centralized market where buyers and sellers or their agents can execute trades. The New York Stock Exchange is an auction market. The over the counter market has no central exchange facility and operates through dealers who buy or sell a security upon request. NASDAQ is an over the counter market. There are also markets for derivative instruments (options, futures and swaps) which provide for risk transfer.

For information on the New York Stock Exchange and NASDAQ go to

<http://www.nyse.com>

For information on NASDAQ

<http://www.nasdaq.com>

To see what it is like being a trader on NASDAQ go to

<http://www.investor.nasd.com>

Click on “Calculators and Games”. Click on “NASDAQ Head Trader”.

For information on futures markets, go to the Chicago Mercantile Exchange's website

<http://www.cme.com>

1. Go to <http://www.cme.com>
2. Click on "getting started"
3. Go to "web instant lessons"
4. Go to each of the lessons.

### **LEARNING OBJECTIVE: TO LEARN ABOUT RISK AND RETURN**

You have probably heard "the greater the risk, the greater the return." This is true in most cases. The higher the risk associated with an investment, the greater must be the return to induce investors to assume the risk. If you invest in an instrument with a short term maturity (like 3 months) that can easily be sold before maturity (like a Treasury bill) and that is very safe (again a Treasury Bill), then the return is low. If you invest in an instrument that has a longer term maturity, that cannot be as easily sold and that has more risk, you should expect to receive a higher return. Basically, if you invest in low risk – low return short-term instruments, you are concerned about safety. When you invest in longer term instruments, you are more concern with growth and income production. Those instruments that are considered as very safe will offer little income growth. You have to have your money somewhat at risk in order to generate impressive levels of income growth.

It is important to note that the risk and return trade-off applies to holding or purchasing only one investment. Risk can be reduced by diversifying portfolios – that is, holding more than one investment – without sacrificing return. What is meant by risk? Although many people generally think of risk as associated with the probability of lost, most financial economists define risk as the variability in the return of an investment.

Go to

<http://www.online.msdc.com/cgi-bin/WSJ/wsj>

Click on "Investment Basics". Click on "Diversification." In the charts given, the investor could buy all stocks, all bonds or a portfolio that is diversified with 60 percent stocks and 40 percent bonds. The charts are for three years and show that a diversified portfolio performs worse than the better performing choice but better than the worse performing investment in any year. The diversified portfolio also has less risk (its return is less volatile) on average than a portfolio of all stocks or all bonds.

**A WORD TO THE WISE:** Never – as the old adage goes – put all your eggs in the same basket.

So how do you invest your money? Many financial advisors recommend that you have cash assets (Treasury bills, short-term CDs, money market mutual funds) to cover around six months of living expenses. Then you should have most of your money in moderately risky assets (blue chip stocks) and the smallest proportion in your portfolio in the highest risk investments (like new high tech stocks).

**A WORD TO THE WISE:** Diversification is smart if you want to have lower risk *and* income growth.

When you invest you have many choices. Each choice has its own risk and return associated with it. Basically, you can buy real assets such as gold and real estate. You can buy financial assets such as cash instruments, stocks or bonds. In this section we are primarily interested in financial instruments rather than real assets. Although we will discuss each of these in more detail later but for now just keep in mind the following. Cash instruments are short term, highly liquid assets such as Treasury bills. Stocks are ownership shares in a corporation. Bonds are debt instruments in corporations or the government. You can buy these instruments individually or you can buy shares in a mutual fund which will purchase instruments for you. Mutual funds are the vehicles that many investors use to diversify their portfolios and to reduce their risk.

How much can you invest? Go to

<http://www.investor.nasd.com>

Click on “Learning to Invest”.

The Wall Street Journal’s Guide To Understanding Money And Investing is one of the best sources of information. You can find it at

<http://www.online.msdc.com/cgi-bin/WSJ/wsj>

### **LEARNING OBJECTIVE: TO FIND OUT WHAT TYPES OF INVESTMENT INSTRUMENTS ARE OUT THERE**

There are many types of financial instruments out there ranging in maturities from one day to infinity. Some of these instruments are

INSTRUMENT	ISSUER	MATURITY
FED FUNDS	BANKS	1 DAY
T BILLS	US TREASURY	3-12 MONTHS
COMMERCIAL PAPER	LARGE CORPORATIONSS	LESS THAN 90 days
BANKERS ACCPTS	BANKS	3 MONTHS
AGENCY NOTES	FEDERAL AGENCIES	12 MONTHS
EURODOLLARS	OVERSEAS BANKS	1-6 MONTHS
S-T TAX EXEMPTS	STATE AND LOCAL GOVERNMENTS	LESS THAN 1 YR
STOCKS	CORPORATIONS	NO MATURITY
BONDS	US TREASURY, STATE AND LOCAL GOVERNMENTS AND CORPORATIONS	UP TO 100 YEARS

For detailed information on short-term financial instruments that mature in less than one year, see the Federal Reserve Bank of Richmond's "Instruments of the Money Market".

<http://www.rich.frb.org/instruments>

**A WORD TO THE WISE:** Young investors should be aware that there may be a minimum age requirement to actively participate in these markets. There is usually a minimum age of 18 for purchasing shares in a mutual fund.

## STOCKS

Most people are interested in the stock market. Here great fortunes have been gained (and lost). But importantly for most of us, the stock market has been a source of additional income and a place where we put our money for long-term gains. Many people have their retirement funds invested in stocks. They invest themselves or through mutual funds managed by professional investors. So lets learn a little bit about stocks.

Stocks generally come in two forms: common stock and preferred stock. Common stock represents ownership of the firm and is a perpetual claim (it never matures). It is a residual claim against the assets of a firm. Investors buy common stock for capital gains and dividends (income). The legal rights of stockholders are the control of the firm. They elect the firm's directors who select the officers. Each share of stock is one vote and a stockholder can vote by

proxy. The market for common stock can be closely held (the shares are not sold to the general public) or publicly held. Stocks are issued in the primary market and traded in the secondary market.

Preferred stock pays a stated dividend expressed as a percentage of par. If dividends are not paid, they become cumulative and must be paid before dividends can be paid to common stockholders. Preferred stock carries no voting rights (except when dividends are not paid). Most preferred stock is held by corporations, rather than individuals. Corporations can deduct 85% of preferred stock dividends from taxable income.

A great site for providing information to high school students on the stock market (complete with tutorials) is

<http://library.thinkquest.org/3088/>

An interactive stock market learning project designed for high school students is

<http://www.ncsa.uiuc.edu/edu/RSE/RSEyellow/gnb.html>

There are many sites that provide up-to-date market information, analysis and advice. Some are

<http://www.marketguide.com>

<http://www.clearstation.com>

<http://www.abovetrade.com>

<http://www.stockselector.com>

<http://www.financialengines.com>

<http://www.wallstreetcity.com/>

<http://www.tfc.com>

One site is specifically targeted to young investors. It is

<http://www.younginvestor.com>

If you are interested in seeing how to trade stocks try some of these sites:

<http://www.fidelity.com>

<http://www.datek.com>

<http://www.etrade.com>

<http://www.ndb.com>

<http://www.dljdirect.com>

## **BONDS**

Bonds are long-term instruments whose main purpose is long term savings. A bond is a long term contract under which the borrower agrees to make timely payments of interest and principal. Risk is major element for bonds in that they have a long life span and a lot of bad things can happen to the company over that period of time. The business could suffer a downturn and default on its bond payments. If this happens, the bond holders can force bankruptcy. Also many bonds pay a periodic coupon. If interest rates fall, coupon holders will find that if they reinvest the coupons, they will do so at a lower rate.

Corporations are major suppliers of bonds. The government is also a supplier. There are Treasury bonds and bonds supplied by state and local governments. Although individuals buy bonds, most holders are corporations.

There are many types of bonds (secured and unsecured, marketable and nonmarketable, convertible into stock and nonconvertible). Different investors prefer different types of bonds. Some of the different types of bonds are

1. Mortgage bond - the corporation pledges certain real assets as security for the bond.
2. Debentures - an unsecured bond. Holders are general creditors whose claims are protected by property not otherwise pledged.
3. Subordinated debentures - the junior status of the bond is specified. Can be subordinated to designated notes payable such as bank loans or to all other debt
4. Zero coupon bonds – a bond that does not pay a periodic coupon but pays the face value upon maturity.
5. Index or purchasing power bonds – a bond tied to the rate of inflation or pegged to the price of a commodity.

For information on bonds, go to

<http://www.smartmoney.com>

<http://www.briefing.com>

<http://www.investinginbonds.com>

<http://www.firstinstitutional.com/index.html>

<http://www.bondmarkets.com>

<http://www.govpx.com/govrpt>

## **MUTUAL FUNDS**

Money market mutual funds are financial intermediaries that purchase pools of short-term financial instruments and sell shares in these pools to savers. Mutual funds are operated mainly by brokerage companies. Generally the minimum initial investment is between \$500 and \$5,000. Often there is a check writing option with a minimum of \$500 a check. These accounts are not insured by the FDIC.

Since mutual funds purchase pools of short-term instruments, they are by definition diversified. Each mutual fund will buy within a particular range of assets. For example, some will buy the S&P 500, others will buy international stocks and others will buy government securities. Therefore, you can diversify your portfolio by buying different types of mutual funds.

For mutual funds on the internet see

<http://www.vanguard.com>

<http://www.schwab.com>

<http://www.dreyfus.com>

<http://www.fidelity.com>

<http://www.franklintempleton.com>

<http://www.kemper.com>

<http://www.troweprice.com>

**THINGS TO DO:**

Go to

<http://www.edgate.com>

Click on “Practical Money Skills for Life”.

Click on “For Teachers”.

Click on “Lesson 12, Saving and Investing”.