

# **Novae Wealth Guide**

**A Beginner's Guide to Securing  
Your Financial Future**

# novae Wealth

## *A Beginner's Guide to Securing Your Financial Future*

You can create personal wealth. It's possible to meet your financial goals. By choosing to budget, save and invest, you can pay off debt, send your child to college, buy a comfortable home, start a business, save for retirement and put money away for a rainy day. Through budgeting, saving and investing, building credit and controlling debt, all these goals are within your reach.

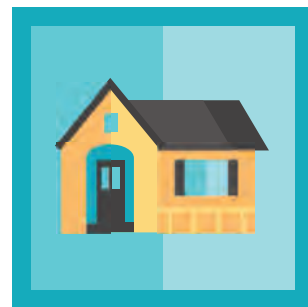
### **Defining Wealth**

Some people consider themselves wealthy because they live in a very expensive house and travel around the world. Others believe they are wealthy simply because they're able to pay their bills on time. What we are talking about here is financial wealth and what it means to you.

Building wealth requires having the right information, planning and making good choices. This workbook provides basic information and a systematic approach to building wealth. It is based on time-honored principles you probably have heard many times before—budget to save; save and invest; build credit and control debt; and protect the wealth you accumulate.

Some people might define wealth as:

- being able to put my kids through college.
- having enough money to buy a house.



**What is your definition of wealth?**

1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_

You have defined wealth.  
**How do you acquire it?**

*If you make a good income  
each year and spend it all,  
you are not getting wealthier.  
You are just living high.*

Thomas J. Stanley and William D. Danko,  
*The Millionaire Next Door*



You want to create personal wealth, right? So does Anthony.

Anthony is 35 and works for a manufacturing company. He looked at his finances and realized that at the rate he was going, there wouldn't be enough money to meet his family's financial goals. So he chose to embark on a personal wealth-creation strategy. His first major step was to pick up a copy of this workbook for guidance. Anthony began by learning the language of wealth creation. The first lesson was to understand the meaning of assets, liabilities and net worth. They make up this very important formula:

$$\text{ASSETS} - \text{LIABILITIES} = \text{NET WORTH}$$

A wealth-creating **asset** is a possession that generally increases in value or provides a return, such as:

- A savings account.
- A retirement plan.
- Stocks and bonds.
- A house.

Some possessions (like your car, household furnishings and clothes) are assets, but they aren't wealth-creating assets because they don't earn money or rise in value. A new car drops in value the second it's driven off the lot. Your car is a tool that takes you to work, but it's not a wealth-creating asset.

A **liability**, also called debt, is money you owe, such as:

- A home mortgage.
- Credit card balances.
- A car loan.
- Hospital and other medical bills.
- Student loans.



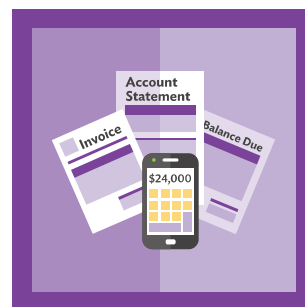
### Home Equity

The market value of a home is an asset; the mortgage is a liability. Let's say your house is worth \$120,000, but your mortgage is \$80,000. That means your equity in the home is \$40,000. Equity contributes to your net worth.

**Net worth** is the difference between your assets (what you own) and your liabilities (what you owe). Your net worth is your wealth.

To calculate how much he is worth, Anthony used the following formula: **Assets – Liabilities = Net Worth**. He made a balance sheet listing all his assets and all his liabilities. He listed his wealth-building assets first.

Anthony discovered his net worth is \$24,000.



**ASSETS**

**(MINUS)**

**LIABILITIES**

**(EQUALS)**

**NET WORTH**

Anthony's Balance Sheet	
Wealth-building assets	Amount
Cash	\$ 1,500
Savings account	1,000
Stocks, bonds and other investments	5,000
401(k) retirement plan/IRA	25,000
Market value of home	0
<b>Other assets</b>	
Market value of car	14,000
<b>Total assets</b>	<b>\$ 46,500</b>
Liabilities	Amount
Home mortgage	\$ 0
Home equity loan	0
Car loan balance	13,000
Credit card balances	3,000
Student loan	5,000
Miscellaneous liabilities	1,500
<b>Total liabilities</b>	<b>\$ 22,500</b>
<b>Net worth</b>	<b>\$ 24,000</b>



### Figure Your Net Worth

Using Anthony's balance sheet as an example, complete the blank balance sheet on page 33. Be sure to add any assets or liabilities you have that are not listed on Anthony's sheet.

Remember that net worth is your wealth.

**Are you where you want to be?**

*It takes as much energy  
to wish as it does to plan.*

Eleanor Roosevelt



**What would you like your net worth to be?**

5 years from now? \$ \_\_\_\_\_

10 years from now? \$ \_\_\_\_\_

### Set Financial Goals

Most people who have built wealth didn't do so overnight. They got wealthy by setting goals and pushing themselves to reach them. Anthony set two short-term goals: (1) to save \$3,000 a year for three years to have \$9,000 for a down payment on a house, and (2) to add \$500 to his emergency fund in one year. Anthony also set two long-term goals: (1) to save and invest enough to have \$25,000 in 15 years for his children's college education, and (2) to have \$5,000 a month to live on when he retires in 30 years.



### Tip: Financial Goals

A personal wealth-creation strategy is based on specific goals.

In preparing your goals:

- Be realistic.
- Establish time frames.
- Devise a plan.
- Be flexible; goals can change.



**What are your short-term and long-term goals?**

My short-term goals are:

1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_

My long-term goals are:

1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_

You have set short- and long-term goals.  
**How do you meet them?**

## Develop a Budget and Live by It

When it comes to reaching your financial goals, are you doing or wishing? The difference is doers put action to their goals. And doers are much more likely to reach their goals and achieve their dreams.

If you are a doer, you are more likely to:

- Track spending.
- Live within your means.
- Stick to a budget.
- Pay off credit cards in a timely way.
- Deposit money into savings each month.
- Make regular contributions to retirement savings.

To maximize your wealth-creating ability, you want to be a doer, like Sonya.

Sonya is a single parent with one child. She budgets in order to live on her modest income and tracks where every dime goes. Saving is very important to her. When her son was born, she started investing every month in a mutual fund for his college education. Sonya is a homeowner, has good credit and never loses sleep over paying her bills. Sonya controls her future.

Gabby, by contrast, doesn't put action to her dreams. Gabby has a good job, makes good money and lives a pretty comfortable life, but her bank statement tells a different story. She has no savings or investments, owns no property and has no plans for retirement. Plus, she's got a lot of credit card debt, lives from paycheck to paycheck and doesn't budget.

You can choose to be like Gabby, or you can follow Sonya's road to wealth creation by learning to budget and save.

A budget allows you to:

- Understand where your money goes.
- Avoid overspending.
- Find money for saving and investing to build your wealth.

To develop a budget, you need to:

- Calculate your monthly income.
- Track your daily expenses.
- Determine how much you spend on monthly bills.





### Track Day-to-Day Spending

One day, Gabby realized that to create wealth she had to become more of a doer, like Sonya, and plan her financial future. To start, Gabby looked at her finances to see how much money she made and how she was spending it. She set a goal to save \$125 a month to put toward her wealth-creation goals. First, she calculated her income. Then she added up her monthly bills.

She also kept track of her daily spending, whether by cash or debit card, check or credit card. Here is a page from her notebook.



Gabby's Day-to-Day Spending

Date	Expense	Cash/debit/check	Charge
1/2	Breakfast, Get-N-Go	\$ 5.50	
1/2	Coffee	3.75	
1/2	Lunch		\$ 6.75
1/2	Gas for car		46.00
1/2	Drinks with friends	10.00	
1/2	Groceries		50.00
1/2	Dinner	15.00	
1/2	Music	10.00	
1/3	Breakfast, Moonlight Diner	8.50	
1/3	Coffee	3.75	
1/3	Dress		50.00
1/3	Movies	15.00	
1/3	Dinner	18.00	
1/4	Breakfast, Get-N-Go	5.50	
1/4	Coffee	3.75	
1/4	Birthday present		20.00
1/4	Lunch		15.00
1/4	Household supplies	30.00	
1/4	Coffee	3.75	
1/4	Pizza	15.00	



### Track Your Daily Spending

Using Gabby's spending log as an example, record your daily expenses on the blank day-to-day spending form on page 34. Include everything you purchase—whether with cash, debit card, check or credit card.

You know how to track where your money is going.  
**Do you need to make a change?**

## Get a Handle on Income and Expenses

Gabby used the information from tracking her day-to-day expenses to develop a monthly budget. When Gabby reviewed her budget, she realized she was spending more than she earned. This means she was building debt, not wealth. Gabby knew if she were ever going to save \$125 a month, she had to cut her expenses, earn more money, or both. She worked overtime at her company, which increased her take-home pay. She bought fewer clothes, discontinued premium cable TV channels, carpooled to work to cut gas consumption and reduced her spending on eating out and entertainment. Tracking her expenses paid off. Gabby successfully developed a budget that enables her to save \$125 each month.

Here is her budget. If Gabby sticks to it, she will have \$125 a month that she can:

- Put in a savings account.
- Invest in a 401(k) retirement plan at work.
- Invest in an individual retirement account (IRA).
- Invest in stocks, bonds or mutual funds.
- Use to pay off debt.

These are just some of the wealth-building choices available when you budget to save.



### Tip: Saving

To help you maintain the discipline to save:

- Save every month.
- Have savings automatically deducted from your paycheck or checking account.
- Base your budget on what's left.

In other words, get on automatic pilot and stay there.

### Gabby's Monthly Budget

	Current income	Income changes	New budget
Take-home pay	\$ 2,600		\$ 2,600
Overtime pay		\$ 40	\$ 40
Pension, Social Security benefits			
Alimony/child support			
Other income			
<b>Total income</b>	<b>\$ 2,600</b>	<b>\$ 40</b>	<b>\$2,640</b>

	Current expenses	Spending changes	New budget
Rent	\$ 750		\$ 750
Renter's insurance	30		30
Utilities	155		155
Telephone	100		100
Cable TV/Internet service	75	-20	55
Insurance (life, disability)	0		0
Charitable donations	0		0
Credit card payment	200		200
Groceries	200		200
Clothing	130	-30	100
Day care/tuition	0		0
Car loan	300		300
Car insurance	75		75
Gas for car	145	-20	125
Meals out & entertainment	425	-50	375
Miscellaneous daily expenses	100	-50	50
<b>Total expenses</b>	<b>\$ 2,685</b>	<b>\$ -170</b>	<b>\$ 2,515</b>
<b>Monthly net</b> (income - expenses)	<b>\$ -85</b>		<b>\$ 125</b>
<b>Available to save or invest</b>	<b>\$ 0</b>		<b>\$ 125</b>



### Budget to Save

Using Gabby's budget as an example, track your income and expenses on the blank monthly budget sheet on page 35. Identify changes you can make to increase your income or decrease your expenses. Then develop a new budget that includes more savings. Be sure to make changes that you can live with from month to month.

You know how to successfully budget to save.  
**How will you invest your savings?**



*Take the power of compound interest seriously—  
and then save.*

Dwight R. Lee and Richard B. McKenzie,  
*Getting Rich in America*



You have budgeted and identified an amount to save monthly. Where are you going to put your savings? By investing, you put the money you save to work making more money and increasing your wealth. An **investment** is anything you acquire for future income or benefit. Investments increase by generating income (interest or dividends) or by growing (appreciating) in value. Income earned from your investments and any appreciation in the value of your investments increase your wealth.

### Get Guidance

There is an art to choosing ways to invest your savings. Good investments will make money; bad investments will cost money. Do your homework. Gather as much information as you can. Seek advice from licensed or registered advisers. States require licensing or registration for brokers, investment advisers and insurance salespeople, so check with your state securities regulator before trusting any investment adviser. Also, check out the Wealth-Building Resource Guide on page 30 for helpful sites.

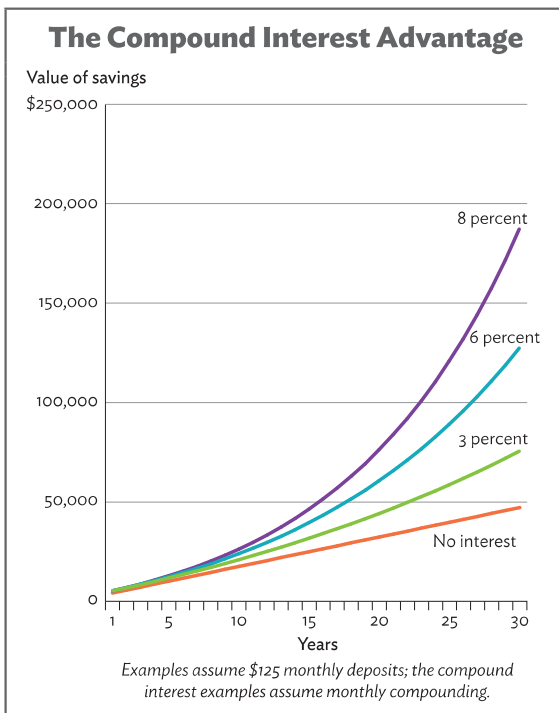
### Take Advantage of Compound Interest

**Compound interest** helps you build wealth faster. Interest is paid on previously earned interest as well as on the original deposit or investment. For example, a \$5,000 investment earning 6 percent interest for a year earns \$308 if the interest is compounded monthly. In just five years, the \$5,000 will grow to \$6,744.

Let's see how interest compounds on Gabby's savings. Assume that Gabby saves \$125 a month for 30 years and the interest on her savings is compounded monthly.

The chart to the left shows how compound interest at various rates would increase Gabby's savings compared with simply putting the money in a shoebox. This is compound interest that you earn. And as you can see from Gabby's investment, compounding has a greater effect after the investment and interest have increased over a longer period.

There is a flip side to compound interest. That is compound interest you are charged. This compound interest is charged for purchases on your credit card. Chapter 4, "Build Credit and Control Debt," discusses this type of interest.



## Understand the Risk-Return Relationship

When you are saving and investing, the amount of expected return is based on the amount of risk you take with your money. Generally, the higher the expected return, the higher the risk of losing money. For less risk, an investor will expect a smaller return.

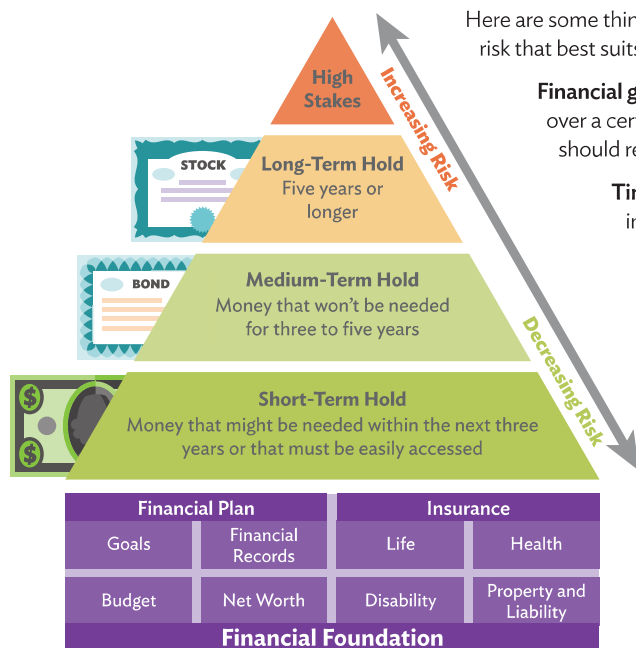
For example, a savings account at a financial institution is fully insured by the Federal Deposit Insurance Corp. up to \$250,000. The return—or interest paid on your savings—will generally be less than the expected return on other types of investments.

On the other hand, an investment in a stock is not insured. The money you invest may be lost or the value reduced if the investment doesn't perform as expected.

After deciding how much risk you are able to take, you can use the investment pyramid to help balance your savings and investments. You should move up the pyramid only after you have built a strong foundation.



### The Investment Pyramid: How Much Risk Do You Want to Take?



Here are some things to think about when determining the amount of risk that best suits you.

**Financial goals.** How much money do you want to accumulate over a certain period of time? Your investment decisions should reflect your wealth-creation goals.

**Time horizon.** How long can you leave your money invested? If you will need your money in one year, you may want to take less risk than you would if you won't need your money for 20 years.

**Financial risk tolerance.** Are you in a financial position to invest in riskier alternatives? You should take less risk if you cannot afford to lose your investment or have its value fall.

**Inflation risk.** This reflects savings' and investments' sensitivity to the inflation rate. For example, while some investments such as a savings account have no risk of default, there is the risk that inflation will rise above the interest rate on the account. If the account earns 5 percent interest, inflation must remain lower than 5 percent a year for you to realize a profit.

NOTE: Information not intended as specific individual investment advice.

SOURCES: Adapted from National Institute for Consumer Education, Eastern Michigan University; AIG VALIC.

## Tools for Saving

A good first step toward saving is to open a savings account at a bank or credit union. With a savings account, you can:

- Take advantage of compound interest, with no risk.
- Keep your money safer than in your pocket or at home.
- Take advantage of direct deposit of your paycheck.
- Monitor your balance online.

Financial institutions offer a variety of savings accounts, each of which pays a different interest rate. The box below describes the different accounts. Find the best one for your situation and compare interest rates and fees. You can choose to use these typical accounts to save for the near future or for years down the road.

## Tools for Investing

Once you have a good savings foundation, you may want to diversify your assets among different types of investments. **Diversification** can help smooth out potential ups and downs of your investment returns. Investing is not a get-rich-quick scheme. Smart investors take a long-term view, putting money into investments regularly and keeping it invested for five, 10, 15, 20 or more years.

## Bonds—Lending Your Money

When you buy bonds, you are lending money to a federal or state agency, municipality or other issuer, such as a corporation. A bond is like an IOU. The issuer promises to pay a stated rate of interest during the life

of the bond and repay the entire face value when the bond comes due or reaches maturity. The interest a bond pays is based primarily on the credit quality of the issuer and current interest rates. Firms like Moody's Investor Service and Standard & Poor's rate bonds. With corporate bonds, the company's bond rating is based on its financial picture. The rating for municipal bonds is based on the creditworthiness of the governmental or other public entity that issues it. Issuers with the greatest likelihood of paying back the money have the highest ratings, and their bonds will pay an investor a lower interest rate. Remember, the lower the risk, the lower the expected return.

A bond may be sold at face value (called **par**) or at a premium or discount. For example, when prevailing interest rates are lower than the bond's stated rate, the selling price of the bond rises above its face value. It is sold at a premium. Conversely, when prevailing interest rates are higher than the bond's stated rate, the selling price of the bond is discounted below face value. When bonds are purchased, they may be held to maturity or traded.

**Savings bonds.** **U.S. savings bonds** are government-issued and government-backed. Unlike other investments, you can't get back less than you put in. Savings bonds can be purchased in denominations ranging from \$50 to \$10,000. There are different types of savings bonds, each with slightly different features and advantages. Series I bonds are indexed for inflation.



## Types of Savings Accounts

Savings account (in general)	Money market account	Certificate of deposit (CD)
<ul style="list-style-type: none"><li>• Access your money at any time.</li><li>• Earn interest.</li><li>• Move money easily from one account to another.</li><li>• Savings insured by the FDIC (NCUA for credit unions) up to \$250,000.</li></ul>	<ul style="list-style-type: none"><li>• Earn interest.</li><li>• Pay no fees if you maintain a minimum balance.</li><li>• May offer check-writing services.</li><li>• Savings insured by the FDIC/NCUA up to \$250,000.</li></ul>	<ul style="list-style-type: none"><li>• Earn interest during the term (three months, six months, etc.).</li><li>• Must leave the deposit in the account for the entire term to avoid an early-withdrawal penalty.</li><li>• Receive the principal and interest at the end of the term.</li><li>• Savings insured by the FDIC/NCUA up to \$250,000.</li></ul>

The earnings rate on this type of bond combines a fixed rate of return with the annualized rate of inflation.

If you have paper U.S. savings bonds, you can register them online at TreasuryDirect, [www.treasurydirect.gov](http://www.treasurydirect.gov). Then, you won't have to worry about losing the paper copy.

**Treasury bills, bonds, notes and TIPS.** The bonds the U.S. Treasury issues are sold to pay for an array of government activities and are backed by the full faith and credit of the federal government. **Treasury bills** are short-term securities with maturities of three months, six months or one year. They are sold at a discount from their face value, and the difference between the cost and what you are paid at maturity is the interest you earn. **Treasury bonds** are securities with terms of more than 10 years. Interest is paid semiannually. **Treasury notes** are interest-bearing securities with maturities ranging from two to 10 years. Interest payments are made every six months. **Treasury Inflation-Protected Securities (TIPS)** offer investors a chance to buy a security that keeps pace with inflation. Interest is paid on the inflation-adjusted principal.

Bills, bonds and notes are sold in increments of \$1,000. These securities, along with U.S. savings bonds, can be purchased directly from the Treasury through TreasuryDirect at [www.treasurydirect.gov](http://www.treasurydirect.gov).

Some government-issued bonds offer special tax advantages. There is no state or local income tax on the interest earned from Treasury and savings bonds. And in most cases, interest earned from municipal bonds is exempt from federal and state income tax. Typically, higher-income investors buy these bonds for their tax benefits.

### Stocks—Owning Part of a Company

When you buy **common stock**, you become a part owner of the company and are known as a **stockholder**, or **shareholder**. Stockholders can make money in two ways—receiving dividend payments and selling stock that has appreciated. A **dividend** is an income distribution by a corporation to its shareholders, usually made quarterly. Stock **appreciation** is an increase in the value of stock in the company, generally based on its ability to make mon-



### Rule of 72

The Rule of 72 can help you estimate how your investment will grow over time. Simply divide the number 72 by your investment's expected rate of return to find out approximately how many years it will take for your investment to double in value.

Example: Invest \$5,000 today at 8 percent interest. Divide 72 by 8 and you get 9. Your investment will double every nine years. In nine years, your \$5,000 investment will be worth about \$10,000, in 18 years about \$20,000 and in 27 years, \$40,000.

The Rule of 72 also works if you want to find out the rate of return you need to make your money double. For example, if you have some money to invest and you want it to double in 10 years, what rate of return would you need? Divide 72 by 10 and you get 7.2. Your money will double in 10 years if your average rate of return is 7.2 percent.

ey and pay a dividend. However, if the company doesn't perform as expected, the stock's value may go down.

There is no guarantee you will make money as a stockholder. In purchasing shares of stock, you take a risk on the company making a profit and paying a dividend or seeing the value of its stock go up. Before investing in a company, learn about its past financial performance, management, products and how the stock has been valued in the past. Learn what the experts say about the company and the relationship of its financial performance and stock price. Successful investors are well informed.

### Mutual Funds—Investing in Many Companies

**Mutual funds** are established to invest many people's money in many firms. When you buy mutual fund shares, you become a shareholder of a fund that has invested in many other companies. By diversifying, a mutual fund spreads risk across numerous companies rather than relying on just one to perform well. Mutual funds have varying degrees of risk. They also have costs associated with owning them, such as management fees, that will vary depending on the type of investments the fund makes.

Before investing in a mutual fund, learn about its past performance, the companies it invests in, how it is managed and the fees investors are charged. Learn what the experts say about the fund and its competitors.

Stocks, bonds and mutual funds can be purchased through a full-service broker if you need investment advice, from a discount broker or even directly from some companies and mutual funds.

## Invest for Retirement

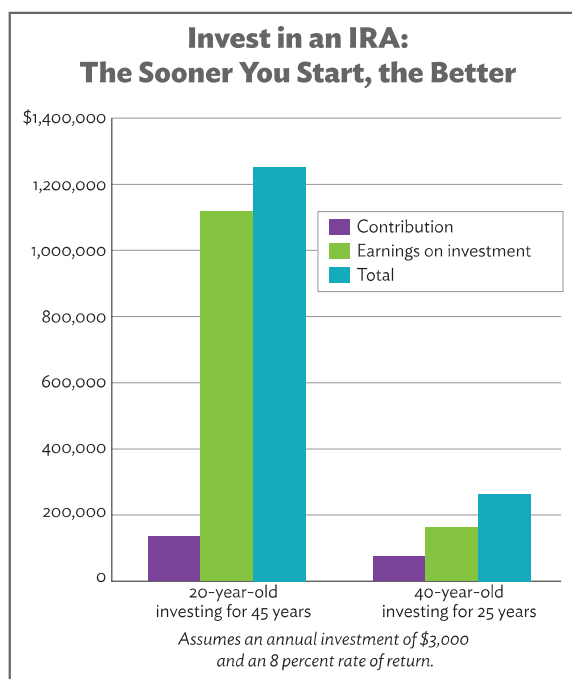
Have you ever thought about how much money you will need when you retire? Will you save enough today to meet your future needs at prices higher than today's due to **inflation**? Many people don't save enough for retirement.

The chart on this page illustrates why it's better to start saving and investing for retirement early in your career. A 20-year-old who begins investing \$3,000 each year toward retirement will have a nest egg over \$1.2 million at age 65 if that investment earns an average annual rate of return of 8 percent. If you wait until you are 40 to start investing, the results are much lower.

## Individual Retirement Accounts

An **individual retirement account (IRA)** lets you build wealth and retirement security. The money you invest in an IRA grows tax-free until you retire and are ready to withdraw it. You can open an IRA at a bank, brokerage firm, mutual fund or insurance company. IRAs are subject to certain income limitations and other requirements you will need to learn more about, but here is an overview of what they offer, with the maximum tax-free annual contributions as of 2014.

You can contribute up to \$5,500 a year to a traditional IRA, as long as you earn \$5,500 a year or more. A married couple with only one person working outside the home may contribute a combined total of \$11,000 to an IRA and a spousal IRA. Individuals 50 years of age or older may make an additional "catch-up" contribution of \$1,000 a year, for a total annual contribution of \$6,500. Money invested in an IRA is deductible from current-year taxes if you are not covered by a retirement



plan where you work and your income is below a certain limit.

A traditional IRA is tax-deferred, meaning you don't pay taxes on the money until it is withdrawn. All withdrawals are taxable, and there generally are penalties on money withdrawn before age 59½. However, you can make certain withdrawals without penalty, such as to pay for higher education, to purchase your first home, to cover certain unreimbursed medical expenses or to pay medical insurance premiums if you are out of work.

A **Roth IRA** is funded by after-tax earnings; you do not deduct the money you pay in from your current income. However, after age 59½ you can withdraw the principal and any interest or appreciated value tax-free.

## 401(k) Plans

Many companies offer a **401(k) plan** for employees' retirement. Participants authorize a certain percentage of their before-tax salary to be deducted from their paycheck and put into a 401(k). Many times, 401(k) funds are professionally managed and employees have

a choice of investments that vary in risk. Employees are responsible for learning about the investment choices offered. By putting a percentage of your salary into a 401(k), you reduce the amount of pay subject to federal and state income tax. Tax-deferred contributions and earnings make up the best one-two punch in investing. In addition, your employer may match a portion of every dollar you invest in the 401(k), up to a certain percentage or dollar amount.

As long as the money remains in your 401(k), it's tax-deferred. Withdrawals for any purpose are taxable, and withdrawals before age 59½ are subject to a penalty. Take full advantage of the retirement savings programs your company offers—and understand thoroughly how they work. They are great ways to build wealth.

### Qualified Plans

If you're self-employed, don't worry. There is a retirement plan for you. A **qualified plan** (formerly referred to as a Keogh plan) is a tax-deferred plan designed to help self-employed workers save for retirement.

The most attractive feature of a qualified plan is the high maximum contribution—up to \$51,000 annually. The contributions and investment earnings grow tax-free until they are withdrawn, when they are taxed as ordinary income. Withdrawals before age 59½ are subject to a penalty.

Check the IRS website—[www.irs.gov](http://www.irs.gov)—for current information on tax-deferred investments.



### How Much Extra Savings Is a Tax-Deferred Investment Worth?

If you pay taxes, which most of us do, a tax-deferred investment will be worth the amount you invest multiplied by the tax rate you pay. For example, if your federal tax rate is 15 percent and you invest \$3,000 in an IRA, you'll save \$450 in taxes. So in effect, you will have spent only \$2,550 for a \$3,000 investment on which you will earn money. A good wealth-creation plan maximizes tax-deferred investments.



### Tip: Investing

Remember, when investing:

- Find good information to help you make informed decisions.
- Make sure you know and understand all the costs associated with buying, selling and managing your investments.
- Beware of investments that seem too good to be true; they probably are.
- Investigate financial professionals *before you invest*. Your state securities board provides free services to check credentials.







## Individual Development Accounts

In some communities, people whose income is below a certain level can open an individual development account (IDA) as part of a money-management program organized by a local nonprofit organization. IDAs are generally opened at a local bank. Deposits made by the IDA account holder are often matched by deposits from a foundation, government agency or other organization. IDAs can be used for buying a first home, paying for education or job training, or starting a small business.

Training programs on budgeting, saving and managing credit are frequently part of IDA programs.

Find an IDA program near you: [cfed.org/idas](https://cfed.org/idas).

## Other Investments

### Investing in Your House

Remember Anthony in Chapter 1, who started reading this workbook to create wealth? Practicing what he read, Anthony reduced his debt, increased his savings and is now ready to buy a house. He has a sizable down payment saved, so right from the beginning he will have equity in his home.

**Equity**, in this case, is the difference between the market value of the house and the balance on Anthony's mortgage. As Anthony pays his mortgage, he increases his equity. Plus, over time, his house may rise in value—giving him more money if he chooses to sell it. Knowing that the more equity he has in his house, the wealthier he will be, Anthony takes a 15-year mortgage rather than the more traditional 30-year mortgage. This will enable him to own his house in 15 years. Of course, Anthony will make higher monthly payments on his mortgage than he would have, but he will build equity quicker and ultimately pay less interest.

By making higher monthly payments, Anthony not only will own his house outright in 15 years, but he will save \$56,126 in interest payments. Making higher monthly payments, of course, means budgeting. Anthony chose to budget extra money each month out of his paycheck—and make wise spending choices—so he can do just that.

### Building Equity Faster—A Comparison

Mortgage term	30 years	15 years
Loan amount	\$118,000	\$118,000
Months to pay	360	180
Annual percentage rate	4.0%	3.0%
Monthly payment	\$563	\$815
Total interest	\$84,806	\$28,680
Interest savings	—	\$56,126



## Start Your Own Business

You can also start and invest in your own business as part of a wealth-creation plan. This requires planning, know-how, savings and an entrepreneurial spirit. Starting a small business can be risky, but it is one of the most significant ways individuals have to create personal wealth.

David had a dream—he wanted to own a business. After serving in the military, he knew that with a little extra training, he could use his skills to start a heating, ventilation and air conditioning company. He and his wife saved every month until they reached their savings goal to start their business. When they felt the timing was right, they bought a van, tools and equipment and set up shop in an old warehouse. David's wife kept her job so they would have steady income and benefits while the business got off the ground.

For the next five years, David worked long hours and put all the income back into the business to help it grow. He gave his customers good service, attracted

more customers and paid close attention to his expenses. By the sixth year, the business was profitable and David and his wife were well on the way to owning a successful, ongoing enterprise that will increase their personal wealth.

None of this would have been possible without budgeting and saving. David was able to use the couple's savings to invest in his talents and entrepreneurial spirit.



### Plan your investment strategy.

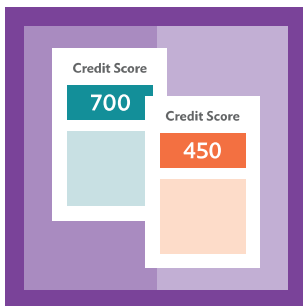
List the investment options you are going to learn more about and weigh them against your wealth-creation goals, time frame and risk tolerance.

1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_
4. \_\_\_\_\_

You budget, save and invest to build your wealth.  
**How do you build your credit?**

*The only reason a great many American families don't own an elephant is they have never been offered an elephant for a dollar down and easy weekly payments.*

Mad Magazine



### Your Credit History Is Important

It's difficult to pay cash for your car, home and college education, so these are typically bought using credit. That is why it's important to have a plan to build and maintain a good credit history. Good credit saves money; bad credit costs money. Think of credit as a tool to be used wisely. Employers, landlords and insurance companies will use credit history to determine whether you are a good risk. A good credit history will result in getting the lowest interest rates for loans and other services, which will put you in a better position to increase your savings and increase your wealth.

Remember the definition of net worth (wealth)?

$$\text{ASSETS} - \text{LIABILITIES} = \text{NET WORTH}$$

Liabilities are debts. Debt reduces net worth. Plus, the interest you pay on debt, including credit card debt, is money that cannot be saved or invested—it's just gone.

If credit is not used wisely, debt can easily get out of hand and may result in late payments. The most important part of your credit history is your track record of paying your bills on time.

### Know What Creditors Say About You

If you have used credit, you will have a credit report that shows everything about your payment history, such as any late payments. When making the decision whether to extend credit, lenders use credit reports, credit scores and other information, such as employment and income history.



#### What's on Your Credit Report?

Consumers have the right to receive annually a free copy of their credit report from each of the three major credit reporting companies:

**Equifax:**  
800-685-1111;  
[www.equifax.com](http://www.equifax.com)

**Experian:**  
888-397-3742;  
[www.experian.com](http://www.experian.com)

**TransUnion:**  
800-888-4213;  
[www.transunion.com](http://www.transunion.com)

These three nationwide consumer credit reporting companies have set up a toll-free telephone number and one central website for ordering free reports: 877-322-8228; [www.annualcreditreport.com](http://www.annualcreditreport.com)



## Know the Score

- The Federal Reserve Board publishes a guide to credit reports and scores for consumers: [www.federalreserve.gov/creditreports](http://www.federalreserve.gov/creditreports)
- The Federal Trade Commission outlines the steps to dispute credit report information and has a sample dispute letter available at [ftc.gov](http://ftc.gov).

The information in your **credit report** is used to create your **credit score**. (For a small fee, you can get your credit score from any of the three credit reporting companies or from [www.myFICO.com](http://www.myFICO.com).) A credit score is a number generated by a statistical model that objectively predicts the likelihood that you will repay on time. Employers, insurance companies, potential landlords, banks and other lenders use credit scores. The higher your score, the less risk you represent to the lender.

A credit report that includes late payments, delinquencies or defaults will result in a low credit score and could cause you to have to pay higher interest rates or be declined altogether. The most important factor in a credit score is the payment history. This history shows whether payments were made on time or late. Recent delinquent payments are more damaging, compared with late payments from many years past. Also, the severity of the delinquency is a factor. For example, a payment made 30 days late has less impact on your credit score than a payment made 60 days late. Another major factor in the credit score calculation is the amount owed on credit accounts. A recommended guideline is to keep your balance at less than half the total credit available on the credit line. This **utilization rate** is an important factor in the credit score calculation.

Factors not considered in a credit score include age, race or ethnicity, income, job, marital status, education, length of time at your current address and whether you own or rent your home.

An important first step in getting the credit you deserve is to check your credit report. Review your credit report at least once a year to make sure all information is accurate. If you find an error, the Fair Credit Reporting Act requires credit reporting companies and those reporting information to them to correct the mistake.

Beware of credit repair services that claim they can erase your bad credit. Many of these are scams. There's no quick fix, but you can improve your credit with time and effort and dedication to your plan.

But how do you establish a credit history if you've never used credit?

Consider a **secured credit card**. This type of card will require a deposit, usually equal to your credit limit. After you have used the secured credit card for a year or more, never maxing out your credit and always paying on time, the credit card provider will typically offer an unsecured card.

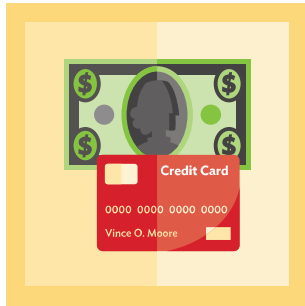
Another type of starter account may be a retail store card or gas card. Before you apply, make sure the card provider will report payments to the credit reporting companies. Some cards, such as **prepaid debit cards**, do not report payments to the credit reporting companies.

If you decide you no longer need a credit account, pay it off and stop using it, but don't close the account. You need those older accounts to show you have a long history of paying on time.



## Tip: Building Good Credit

- Develop a budget and stick to it. Getting a new credit card does not mean you have more income.
- Save money so you're prepared for a rainy day. Three to six months of living expenses are recommended.
- Pay your bills on time.
- Keep your credit card balances low or aim to pay them off monthly.
- Check your credit reports annually and dispute any incorrect information.



## Taking on Debt

A big part of building wealth is making wise choices about credit and debt. Keep in mind your bottom line, your net worth, when making decisions about credit. Remember,  $\text{Assets} - \text{Liabilities} = \text{Net Worth}$ , so when you take on additional debt, you're reducing your net worth. Ask yourself, "Am I building *wealth* and increasing my net worth, or am I building *debt* and reducing my net worth?"

## Are You Ready to Take On a Credit Obligation?

If you don't have a budget, or spending plan, you're not ready to take on debt. Before you take on credit obligations, it's very important to have a good foundation, including your emergency savings, a budget, your financial records and goals, and insurance to protect your assets. See the Investment Pyramid on page 9. Do you have a strong financial foundation?

## The Tale of Two Spenders and the New TV



Remember Sonya? She saved up for the “extras.” When she had enough money in her savings account, she bought a new TV for \$1,500. She paid cash.

Her friend Vince is an impulsive spender. He seeks immediate gratification using his credit cards, not realizing how much extra it costs. Vince bought the same TV for \$1,500 but financed it on a store credit card with an annual interest rate of 22 percent. At \$50 a month, it took him almost four years to pay off the balance.

While Sonya paid only \$1,500 for her new TV, Vince paid \$2,200—the cost of the TV plus interest. Vince not only paid an extra \$700, he lost the opportunity to invest the \$700 in building his wealth.

Doers, like Sonya, are smart about using credit cards as a tool. When doers use credit, they pay off their balances every month. When a credit card balance is not paid off monthly, it means paying interest—often 20 percent or more a year—on everything purchased. This is compound interest that you *pay*. It's not the magical kind of compound interest that builds wealth (see Chapter 3); that's the compound interest that you *earn*.

When you get credit, a loan or a credit card, you repay the **principal**, which is the amount borrowed, plus **interest**, the amount charged for lending you the money.

**Cost of Credit**





Before you borrow, learn everything about the loan, including interest rate, **annual percentage rate (APR)**, **finance charges**, fees and penalties for late payment or early repayment.

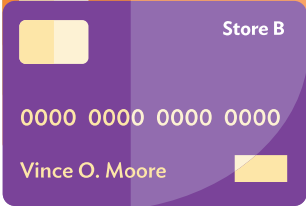
Remember, your credit score determines your cost of credit.

**Take Steps to Control Your Debt**

To manage debt, you need to know how much you have and develop strategies to control it. When Vince decided to reduce his \$3,500 credit card debt, he analyzed his debt, developed a strategy and took action:

- He listed the balance, interest rate and monthly interest on each credit card.
- He checked his credit score and shopped for the best rate on a new credit card. Then he transferred all his balances to that card.
- He cut up the old credit cards and used the interest he saved to pay down his principal balance sooner.

Vince's Credit Cards		Debt	Interest rate	Monthly interest*
	Dept. Store A	\$ 1,500	22%	\$ 27.50
	XYZ Bank	\$ 1,250	17%	\$ 17.71
	BHA Finance Co.	\$ 500	19.5%	\$ 8.13
	Store B	\$ 250	15%	\$ 3.13
<b>Total</b>		<b>\$ 3,500</b>		<b>\$ 56.47</b>



\*Interest rate divided by 12 months multiplied by the amount of debt.



**What is your credit card debt situation?**

Credit card	Debt	Interest rate	Monthly interest*
Total			

\*Interest rate divided by 12 months multiplied by the amount of debt.

My strategy for reducing credit card debt includes:

1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_





#### \$15,000 Car Loan for 5 Years

Lender	Interest rate	Total interest
Pixley Bank and Trust	6.5%	\$2,609.53
XYZ Savings and Loan	7.5%	\$3,034.15
Joe's Auto Sales	15.0%	\$6,410.94

#### \$15,000 Car Loan at 6.5 Percent Interest

	3-year	4-year	5-year
Number of payments	36	48	60
Payment amount	\$ 460	\$ 356	\$ 293
Total paid	\$ 16,550	\$ 17,075	\$ 17,610

## Save Money by Choosing the Right Loan

If you have good credit, you may want to take out a loan to purchase a car or a house or to cover educational expenses—all are investments in the future. But regardless of how the money is spent, a loan is a liability, or debt, and decreases your wealth. So choose loans carefully.

Shop and negotiate for the lowest interest rate. The interest you save can be invested to build wealth. Take a look at the table on the left. It may be obvious which lender will charge the lowest interest. What's not obvious is that your credit score may determine which interest rate you are offered. Obtain your credit score well before you plan to apply for a loan. Use an online auto loan calculator to compare rates. You can save interest expense by increasing your monthly payments or choosing a shorter payment term on your loans. The table also shows how shorter terms with higher payments would affect the total amount and interest on a \$15,000 car loan.

## Beware of High-Cost Credit

People can get deep in debt when they take out a loan against their paycheck or car title. These loans generally come with very high, double-digit interest rates. For example, borrowers may write a postdated check in exchange for money. When they get paid again, they repay the loan, thus the name **payday loan**. Borrowers who can't repay the money are charged additional fees for an extension, which puts them even deeper in debt. Borrowers can continue to pay fees to extend the loan's due date indefinitely, only to find they are getting deeper in debt because of the steep interest payments and fees.

**Predatory lenders** often target seniors and low-income people they contact by phone, mail or in person. After her husband died, 73-year-old Bess needed financial help and fell victim to a predatory lender. Bess was struggling to make ends meet on her fixed income. To pay off her bills, she took out a \$5,000 loan that carried a high interest rate and excessive fees. Soon Bess found she was even deeper in debt, so she refinanced the loan once, then again, and again, paying fees each time.

Bess's children discovered her situation and paid off the loan.



### Tip: Borrowing

- Don't borrow from Peter to pay Paul.
- Never respond to a solicitation that makes borrowing sound easy and cheap.
- Always read the fine print on any loan application.
- Seek assistance from family members, local nonprofit credit counseling services or others to make sure a loan is right for you.

## Keep Your Good Name

Every month, go back to your budget and plan carefully to ensure your bills are paid before their due dates. Setting up direct deposit and putting bills on auto debit can help you keep your good name. Sonya, the doer, makes sure she pays her bills on time. Sonya gets paid twice a month. She has her paycheck set up for direct deposit so she doesn't have to scramble to get to the bank on payday. With her first paycheck each month, she pays her mortgage (which she has set up on auto debit), cable TV and utility bills. Out of the second check, Sonya makes her car payment (also on auto debit) and has a monthly deposit automatically made to her savings account. Sonya has found that "autopilot" really simplifies budgeting and saving.

## Guard Your Identity

Just as you protect the security of your home with locks for your windows and doors, you should take steps to protect your identity. Secure your financial records, Social Security number and card, account numbers, and all passwords and PINs (personal identification numbers). A periodic check of your credit report can alert you if someone is illegally using credit products in your name. If you suspect unauthorized access, contact the three major credit reporting companies (see box on page 16) and place a fraud alert on your name and Social Security number.



### Tip: Protect Your Identity

- Shred or destroy your bank and credit card statements and all other private records before tossing them in the trash.
- Give out your Social Security number only when absolutely necessary, and never carry both your Social Security card and driver's license in your wallet.
- Pick up mail promptly from your mailbox, and never leave outgoing mail with paid bills in an unsecured mailbox.
- Don't give out personal information on the phone, through the mail or on the Internet unless you're sure you know with whom you're dealing.

Date	Description	Amount	Balance
6/1	Deposit	\$ 1,350	\$ 6,000
6/1	Mortgage	750	5,250
6/8	Cable TV	50	5,200
6/10	Utility	150	5,050
6/15	Deposit	1,350	6,400
6/15	Auto loan	325	6,075

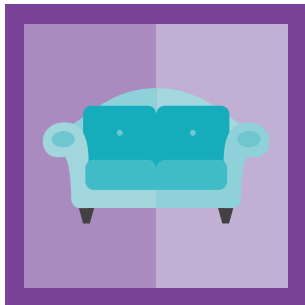
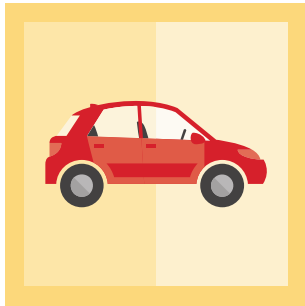


You increase assets and decrease liabilities to build wealth.

**How do you protect it?**

*It is unwise to be too sure of one's own wisdom. It is healthy to be reminded that the strongest might weaken and the wisest might err.*

Mahatma Gandhi



After working hard to create personal wealth, you need to protect it. People acquire insurance to protect themselves from major financial loss. Insurance is simply a promise of reimbursement for a loss in return for a premium paid. When shopping for insurance products, consumers should match their needs with what the product offers and seek out the best deal. A solid credit history is also important because insurers use credit information to price some types of insurance policies. You can buy insurance to cover all kinds of risks, but basic needs can be met with property, health and life insurance.

### Property Insurance

#### Auto Insurance

State laws require that all motor vehicles have **liability** insurance to cover injury to other people or damage to their property. If you have a loan on your vehicle, your lender will also require physical damage coverage on it.

You may select a higher **deductible** (the amount you pay out of pocket before insurance kicks in) and receive a more affordable rate on the **insurance premium** (the cost of the policy). If you have your emergency savings in place, you will feel more confident about taking out a higher-deductible policy, which will lower your premium costs.

#### Home Insurance

If you are renting your home or apartment, you should purchase renters or contents insurance to cover your possessions against loss from fire or theft. Your landlord's insurance will only cover damage to the building, not its contents. Also, if someone is hurt in your rented home, that liability is yours, not the landlord's.

Homeowners insurance covers your home and possessions. The personal liability coverage in a homeowners policy protects you from loss resulting from any injuries that may occur on your property. Your mortgage lender will require you to carry a certain amount of insurance coverage as long as the mortgage is in place. You may also consider a higher-deductible insurance plan to save money on your homeowners coverage.

Standard homeowners coverage insures your home and its contents against loss from such risks as fire and theft. You may require special insurance for flood, earthquake or other risks specific to your area. Contact your state department of insurance for more information on insurance in high-risk areas.

Another type of household protection, a **home warranty**, is a service contract that protects the homeowner from unexpected costs for repair or replacement of major systems. These might include heating and air-conditioning, plumbing, electrical systems or a water heater. Sellers will sometimes provide a one-year home warranty to give potential buyers added confidence. The homebuyer then has the option of renewing the warranty at the end of the year.

## Health Insurance

### Medical Insurance

No one wants to worry about a trip to the emergency room wiping out everything they've saved toward their financial goals. Studies show unexpected medical expenses are the leading cause of bankruptcy in America. Research also tells us that many people cut back on their medications trying to keep medical costs low—a practice that will likely lead to worsening health and higher costs. Many households have significant levels of debt because they didn't have medical insurance or because they didn't have savings to pay the expenses that weren't covered by their health plan. Late payments and defaults on medical debt may be reported on credit reports and affect a person's credit score.

Whether you are shopping for health insurance on the Healthcare.gov marketplace or completing the annual enrollment in your employer's health insurance plan, consider your budget and short-term savings balance. Medical insurance pays for some, but not all, of your doctor, hospital and prescription drug costs. Do you have enough emergency savings to cover the deductible and out-of-pocket copays? When you estimate the number of copays for doctor visits in a year, you might find that the health plan with the lowest premium is not such a good deal. Choose your medical coverage/deductibles carefully, and consider your household circumstances. For example, if your kids participate in sports, be sure you are covered in the event of an injury.

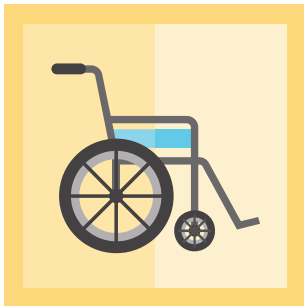
The Affordable Care Act requires that most Americans obtain health insurance or pay a penalty (the individual mandate). The penalty, or per month fee, is added to your personal income taxes due for the tax year and could reduce your tax refund. Families earning between 100 percent and 400 percent of the federal poverty level are eligible for a premium tax credit if they are not eligible for employer-provided coverage and if they enroll in the Healthcare.gov marketplace for coverage during the enrollment period. Payments of the premium tax credits go directly to the insurance company selected by the enrollee to pay a share of the monthly premium.





People eligible for Medicaid may enroll anytime throughout the year. Parents can also apply for Children's Medicaid (CHIP) for their children year-round. Every state provides free or low-cost health insurance for children in low- to moderate-income households. For more information about state programs, contact the U.S. Department of Health and Human Services at 877-Kids Now (877-543-7669) or go to [www.insurekidsnow.gov](http://www.insurekidsnow.gov).

Basic medical coverage can promote preventive health care, which is very important for you and your children. Your family's health is an asset. Protecting your health and having basic medical insurance coverage can give you peace of mind to focus on achieving your other life goals.



People who are insured through their employer should consider participating in a **flexible spending account (FSA)** if it is offered. An employer-sponsored FSA allows employees to save pretax dollars in an account to cover deductibles, copays, prescription and over-the-counter drugs, and other health expenses not covered by insurance. Employees need to plan their FSA spending so they have enough saved to cover their uninsured medical expenses but not more than they can use in one year plus two and a half months. On March 15 every year, money left in an FSA from the previous year is forfeited.

Even if you have health insurance, you should make sure your emergency savings account is adequate to provide a safety net against unexpected medical costs.

### Disability Insurance

Statistics show that you have a higher risk of becoming disabled than of dying before age 65. Disability insurance helps you pay living expenses if you are sick or injured and unable to work for a long time. Your employer may offer this insurance in its benefits plan. Consider buying this protection even if you have to pay for part of the premium.



### Buy Insurance Wisely

Insure U, a website sponsored by the National Association of Insurance Commissioners representing insurance regulators from across the United States, has more information on buying all types of insurance at [www.insureuonline.org](http://www.insureuonline.org).

## Life Insurance

The need for life insurance depends on a person's circumstances. In the event of your death, life insurance pays money to the person you choose (your beneficiary). Life insurance helps give financial protection to your children, spouse, parents or even your business.

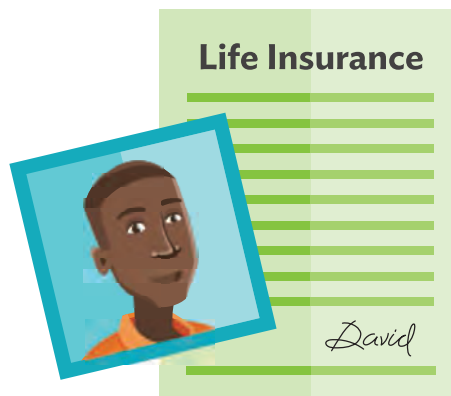
While some types of life insurance offer savings and investment components to keep the future cost of premiums lower or to increase the death benefit, they are not a substitute for a savings or investment plan. Low-cost term insurance, often available through your employer, can offer protection for young families.

Personal accident insurance may also offer a cushion to families if a member dies or is seriously injured in an accident. This kind of insurance is often available through your employer or other provider at relatively low cost.

## Long-Term Care Insurance

If you or a family member became very ill and needed a nursing home, who would pay for it? You would, until all your assets and those of your spouse are exhausted. Only then would government assistance help cover these needs. Long-term care insurance is not medical insurance, but it pays for such health-related items as nursing home, assisted living or in-home care.

Generally, the need for long-term care comes late in life, but insurance premiums are much less expensive when you are younger. Some employers offer access to long-term care insurance for employees to purchase, but most consumers have to find coverage themselves. Shopping for long-term care insurance takes research, common sense and attention to the policy's details.



### Tip: Protecting Your Wealth

There are many types of property, health and life insurance, so do your research and seek good advice.

- Take advantage of group insurance through your employer or other associations you may have.
- Anticipate the needs of your family and decide how much you can afford to pay.
- Shop around and get at least two quotes.
- Consider a higher deductible to lower your premium.
- Ask about other discounts that may be available (for a good driving record, safety equipment, multiple policies with the same provider, etc.) to reduce your cost of coverage.
- Review your insurance coverage annually to make sure you have appropriate coverage as your situation changes.
- As with all investments, be sure to get all the facts before parting with your hard-earned money.





# Review

## Has your definition of wealth changed?

Now that you've read this workbook and thought about the information it contains, how would you define wealth? In the space provided, write your definition. Then compare it with the definition you wrote back on page 1.

Wealth is:

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## Reset your financial goals.

Now, write your financial goals and compare them with your original goals, on page 4. Keep these new goals with your definition of wealth. Periodically refer to your goals and measure your **Assets – Liabilities = Net Worth** to make sure your wealth-building program stays on track.

My short-term goals are:

1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_

My long-term goals are:

1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_

## What are your key wealth-building strategies?

Now, write your own strategies for building wealth. Keep in mind the following:

- Educate yourself about money.
- Establish financial goals.
- Create a budget.
- Save each month, using automatic deduction.
- Take advantage of compound interest.
- Take advantage of tax-deferred investments.
- Research and learn about the best investments for you based on your financial goals, time horizon and tolerance for risk.
- Build credit; use it wisely.
- Control debt.
- Protect your wealth.

My strategies for building wealth are:

1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_

My strategies for building credit and controlling debt are:

1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_

Keep your definition of wealth and your goals firmly implanted in your mind, and use your wealth-creating and debt-controlling strategies every day.

Start budgeting, saving and investing today.  
**Every day counts in building wealth.**