Learn Now, or Pay Later

Abridged Edition

A beginner's guide to credit, debt, and personal finance

CAMBRIDGE
CREDIT COUNSELING CORP.®
Simple, Safe Financial Solutions

By Thomas J. Fox with Martin Lynch

Learn Now or Pay Later

3rd Edition

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With

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About Cambridge Credit Counseling Corp.

Cambridge is dedicated to promoting a more knowledgeable and financially responsible America: by teaching sound money management practices; by assisting financially distressed individuals and families through appropriate counseling, education and advice; and by providing people with information and resources needed to obtain, maintain and sustain housing. Our Counseling Department is comprised of AFCPE *Accredited Credit Counselors*, and our Housing Department is staffed by NCHEC *Certified Housing Counselors*. Our experienced staff is dedicated to helping people understand and manage their finances by providing personalized attention and a free, comprehensive review of each consumer's financial situation. Our agency has been approved by the U.S. Department of Housing and Urban Development. Our reverse mortgage counseling program has been approved by the Massachusetts Executive Office of Elder Affairs. Cambridge is also approved to issue certificates evidencing completion of a personal financial management instructional course by the U.S. Department of Justice Executive Office for United Sates Trustees (EOUST), as required under the Bankruptcy Code. However, this approval does not endorse or assure the quality of our services. Cambridge Credit Counseling Corp. is located at 67 Hunt Street, Agawam, MA, 01001. Please visit us online at www.cambridgecredit.org or contact our office at 1-800-CAMBRIDGE.

About Thomas J. Fox

Thomas J. Fox is the Community Outreach Director at Cambridge Credit Counseling Corp. Mr. Fox is an AFCPE-*Accredited Credit Counselor* and a NCHEC *Certified Housing Counselor* who, over the last decade and a half, has created a number of guidebooks, DVDs, and educational curricula designed to educate young people and low-income individuals about personal finance. Currently, Mr. Fox produces and hosts an online financial literacy show, *Your Money 2.0* on Cambridge's YouTube Channel and co-hosts *Uconomy: Macro Made Micro* on the Businews Channel. Mr. Fox has been interviewed for a variety of news segments regarding personal finance. Some of the outlets that have utilized his expertise include Reuters, CNN Money, Fox Business, MSN Money, Money Matters, Bankrate.com, CreditCards.com, SmartMoney.com, The Wall Street Journal, the Springfield Republican, BusinessWest Magazine, and local television stations WWLP, WGGB and CBS-3 Springfield.

About Martin Lynch

Martin Lynch is the Director of Education and Compliance Manager at Cambridge Credit Counseling Corp. Mr. Lynch joined Cambridge Credit in 2004 and is an AFCPE-*Accredited Credit Counselor*, an NCHEC *Certified Housing Counselor,* and a NeighborWorks-certified HECM counselor. In his role as Director of Education, Mr. Lynch is responsible for maintaining all aspects of client and employee financial education, including the certification and continuing education programs conducted for Cambridge's counselors. In addition to employee education, Mr. Lynch oversees Cambridge's public seminar programs. As Compliance Manager, he is responsible for securing and maintaining appropriate state licenses and bonds, and for ensuring that the agency's activities are compliant with all applicable laws and regulations. He currently serves on the STEM-21 Advisory Board of Springfield's High School of Science and Technology, and is also a member of the Board of Directors of the Association of Credit Counseling Professionals.

About Christopher Viale

Christopher Viale is the President and Chief Executive Officer of Cambridge Credit Counseling Corp. He is responsible for all aspects of the day-to-day operations of the organization, including the direction and oversight of all human resource activities, educational initiatives, public outreach campaigns and employee training programs. In addition to his duties as President, Mr. Viale is an AFCPE-*Accredited Credit Counselor*, an NCHEC *Certified Housing Counselor*, and is one of just a few reverse mortgage counselors approved by the Massachusetts Executive Office of Elder Affairs to counsel senior residents of the Commonwealth. Mr. Viale's years of counseling agency experience and passion for providing ethical and effective debt relief remedies have helped establish Cambridge as a counseling industry leader. Among the outlets that have featured Mr. Viale are the Wall Street Journal, the Los Angeles Times, the Dow Jones Newswire, the Washington Times, CNN Money, CNBC, MSN Money, and Bankrate.com. Mr. Viale also serves as Vice President of the Association of Independent Consumer Credit Counseling Agencies.

About Learn Now or Pay Later

There are hundreds, if not thousands, of personal finance books available these days, so what makes *Learn Now or Pay Later* different? This booklet is a beginner's guide to money management. Before you can run, you need to know how to walk, and that's the approach we've taken with *Learn Now or Pay Later*. Our book will help you identify the building blocks of a sound financial plan. You'll learn about the emotional relationship people have with money, and how to look at your finances in a more positive and productive manner. We'll also cover important topics such as building a Spending Plan, establishing short- and long-term financial goals, reading your credit reports, understanding your credit scores, and how to use credit wisely.

If you've experienced difficult times, not to worry. *Learn Now or Pay Later* also provides information on how to regain control of your financial life, fight identity theft, and ideas for dealing with aggressive debt collectors. It's your money. We're here to help you learn how to use it today, so you're not paying a high price tomorrow.

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Money and Your Mind

Although money may not be able to buy happiness, it *is* an important part of life. And yet, until recently, very few schools have taught the fundamentals of money management and credit. As a result, many of us have adopted our spending and saving behaviors from our environment, and some of us find it difficult to manage our money or make an effective plan for the future. This guide is intended to address these shortcomings.

Contrary to popular belief, the key to financial success isn't being born wealthy or having friends in high places, it's making informed decisions. The financial choices we make, big and small, are based on our understanding of some fairly basic financial concepts, and on our willingness to build on that knowledge throughout our life. Knowing the fundamentals of money management is only half the battle, however; we also have to understand the way we relate to money. Maintaining a perspective about the factors that affect our financial decision-making processes is critically important. Why do people spend the way they do?

The Psychology of Spending

One of the hardest things anyone can do is predict their financial future, and, no, daydreaming about winning the lottery doesn't count!   Our culture continually encourages us to live *in the moment*, to seek the instant gratification of our every desire. Unfortunately, indulging these temptations can have serious consequences, not just for our bank accounts on a day-to-day basis, but for our decision-making processes overall. By adopting the attitude that says "Buy first, think later," we run the risk of regarding money as something merely to be spent, rather than as a tool we can use to improve our lives over the long term. Before you attempt to control your spending, it's important that you recognize any behavioral patterns you may be following.

Let's take a moment to review some of the typical spending behaviors displayed by today's consumers. (And consider this fair warning: You may recognize something of yourself in more than one category.)

- **The Scout**: Scouts absolutely refuse to purchase an item until they have thoroughly shopped around for the lowest price available. "I saved $9.99, and all I had to do was spend 12 hours of my time driving around to 7 stores comparing prices." Scouts also often fail to account for the cost of their research, particularly with respect to time.
- **The Pushover**: Pushovers will buy just about anything that's on sale or placed prominently at the checkout counter. This type of spender makes many unplanned purchases and is drawn to items "on sale" like a bear to honey. "I may not need it, but hey, this lighted toilet seat was 50% off!" Merchandise science has developed store layouts with Pushovers in mind.
- **The Escape Artist:** This type of spender shops as a means of escape from everyday woes. "I had a hard day at the office, and the kids are stressing me out. It's off to the mall we go!" This type of spending also draws in elements of entitlement.
- **The Follower**: Followers shop at the best stores and purchase only the finest clothing and accessories so they can belong to the "in crowd." They would rather be audited by the IRS than buy retail. This type of spender strives to be fashionable to maintain the "friends" they have. "I have a rare condition. I break out if I wear anything off the rack."

Followers will spend themselves into debt just to keep up with the Joneses.

- **The Fire Fighter**: Money burns holes in this consumer's pockets. To put out the fire, they spend, spend, spend! As soon as they get some money, it's time to get those things they "always" wanted. "Wow. I'm so glad I got paid on the same day the mall is having a Sale on Absolutely Useless Items!" This is a typical behavior in children, but if they're never taught otherwise, this spending pattern can last forever.
- **The Hard Worker**: Many consumers in today's society work longer and harder than ever, and when they have time off, feel that they've earned the right to spend beyond their means. This type of "entitled" spending is difficult to control, as frustration and impatience are often contributing factors. Feelings of entitlement frequently arise in relationships, especially marriages in which communication is lacking. One person feels that their overspending is justified by the fact that their partner has already engaged in such behavior. This type of spending can also be retaliatory in nature.

These particular spending behaviors don't happen overnight; they take time to take root and develop, and there are obviously more than the few we've chosen to illustrate. One key to managing them effectively is recognizing the specific influences that have combined to mold us and shape us into the type of consumer we've ultimately become. An examination of these factors is useful, and again, you may discover a bit of yourself along the way.

Life, Liberty, and the Pursuit of Happiness through Spending

What is happiness? It may reasonably be described as the fulfillment of our most basic needs. In 1943, the psychologist Abraham Maslow suggested that our needs must be satisfied in a particular order, which he described as a "Hierarchy of Needs," for us to achieve true happiness. Though he would add to the hierarchy in subsequent writings, Maslow initially organized mankind's needs into five groups.

- **Basic Biological Needs**: These are the items we must have to survive, such as air, water, food, sleep, etc. When these needs aren't satisfied we may feel irritated, tense or uncomfortable. These feelings of anxiety motivate us to remedy the situation as soon as possible. Once these needs have been satisfied to a certain extent, we may think about other things.
- **Safety Needs**: Safety needs have to do with establishing stability and consistency in an unpredictable world. We need the physical security of a home, good health and employment, as well as the sense of physical security that comes from being surrounded by family and friends.
- **Love Needs**: Love and belongingness are next in the hierarchy. Humans have a desire to belong to groups: to families, clubs, work groups, religious groups, even gangs. We need to feel loved and accepted by others.
- **Esteem Needs**: There are two types of esteem needs. The first is self-esteem, which results from competence or the mastery of a task. The second has to do with the recognition of your positive actions by others. We need to be respected and, interestingly, we also have a need to respect others.

- **Self-Actualization**: This refers to our inward desire to become everything we're capable of becoming. Only people who have satisfied ALL of their other needs can maximize their potential. They can seek knowledge, peace, aesthetic experiences, self-fulfillment, etc.

What Does This Have To Do With Me?

By now you may be asking yourself, what does any of this have to do with spending behavior? At each level, the satisfaction of the needs we've described often involves spending. According to Maslow, when the needs at *any* of these levels aren't satisfied, we tend to compensate in some fashion. Unfortunately, many individuals compensate by spending money in particularly unproductive and unhealthy ways. In doing so, they often confuse their *needs* with unwarranted *wants or desires*. Let's look at two examples.

- If a person's "Safety Needs" aren't fulfilled, they may come to believe that they don't need anyone, or that they are more important than others. They may shop for items that are an unconscious expression of their superiority (e.g., sports cars, expensive suits or jewelry).
- If a person's "Love Needs" aren't fulfilled, they may feel inadequate and wonder why people don't love them. Their desire to be loved and accepted by others may lead them to purchase clothing and other items that they associate with social acceptability. Teens are especially susceptible to this type of behavior, but adults engage in it, as well.

Whether or not you agree with the specific categories in Maslow's hierarchy, you should recognize that the motivations for our spending behaviors are influenced by factors not always readily apparent to us. We briefly mentioned the confusion of wants with needs. Let's explore this common problem more closely.

Wants vs. Needs

People commonly misinterpret their "*wants*" as "*needs*." This is what leads many to make poor financial choices. We tend to spend our money on things we *think* we need. Do you really *need* a 55-inch TV, the latest video game system or the newest iPhone? These may be great products, but, in truth, we often want these items only to satisfy unreasonable emotional and social desires. We think they will gain us acceptance or happiness.

Spending money on things we *think* we need, or that we *think* will create happiness for us, is based on the notion that we can accurately predict how we'll feel in the future after the item has been purchased. When you say to yourself, "I can't live without that new phone," you're predicting that your life will be much, much better afterward. In fact, you *can* live without a new phone - after all, you would have had to do without one if they had never been invented.

Numerous studies examining the emotional impact of our purchases have confirmed that we overestimate the intensity and the duration of our emotional reactions – the effect our purchases will have on future events. In this case, we believe that buying a TV will create happiness and fulfillment because we can't accurately forecast the emotional consequence of the purchase. Unfortunately for us, the thrill of a new purchase is usually only temporary. As a result, we often find ourselves repeating a pattern very similar to the cycle of debt.

- We purchase an item we mistakenly believe will make us happy.
- The item loses its value to us over time.
- We look for the next item to make us happy, and then another, and so on.

A simple experiment will help keep the *wants* vs. *needs* debate in the forefront of your mind as you shop. For one week, classify every item you see in an advertisement or on a store shelf as a *want* or a *need*. You don't have to have any intent to actually purchase the item, in fact, its better if you don't. You're simply placing each product in one category or the other. It's a revealing exercise, and it can be particularly meaningful if you have children. Invite them to join in, and you'll also help them gain an appreciation for the spending decisions you have to make for your family. You may be surprised at how long the game will linger in your mind beyond that week.

Becoming Happy!

Another step in gaining control of your financial life is coming to the understanding that your self-worth has nothing to do with your net-worth. Money does not make the person - it is who they are on the inside that defines their lives. Many people have lived rich, fulfilling lives without ever earning a six-figure income. They've done so by coming to terms with the fact that wealth is subjective, and most often has nothing to do with earnings. Relinquishing the association of money and self-worth allows individuals to dismantle the psychological barriers holding them back from living productive financial lives.

Easier Said Than Done?

Possibly, but as with anything in life, you have to make a *decision* to change your relationship with money. Most of us are resistant to change; however, many of the greatest personal and professional achievements have been accomplished by taking an unconventional approach to the "norm." You may have to step out of your comfort zone, but it could be the best thing you've ever done. Just like the promise of a new day, a fresh financial perspective can enhance your quality of life.

Change

Changing your relationship with money can be done, and it may take considerable effort and persistence. Although it sounds obvious, one of the first decisions you need to make is to live for yourself, not others. Don't worry about keeping pace with other people's spending habits or lifestyles. Live according to <u>your</u> financial circumstances. Just as you wouldn't want to compete against Olympic gold medalist Michael Phelps if you weren't a great swimmer, "Keeping up with the Jones" isn't possible if you don't have a similar income.

You also shouldn't live in fear of your finances. Your financial dealings are serious; however, *you* are in control, even if it doesn't always feel like it. It's important to recognize that financial choices are just that – choices. You can control your savings, expenses, and even your earnings; however, you have to adopt the mindset to do so. Oftentimes, it is the unconscious boundaries we establish that limit our ability to use money to better our situation. As you begin to build up your feelings of self-worth and develop a positive attitude about yourself and about money, you'll be able to function positively and effectively. Granted, when you're in a difficult financial situation, these ideas can seem daunting, but, in reality, the timing couldn't be better. An unhealthy relationship with money causes far more damage than good. A number of studies have indicated the impact of poor financial decisions. The serious side-effects of a poor relationship with money can include stress, depression, substance abuse, lack of motivation, and a host of related illnesses. There is no point in waiting for your situation to improve before you tackle your money issues. Delaying would be like waiting until the rain stops before you buy an umbrella.

One of the more challenging aspects of your transformation can be refocusing on the things that bring you joy. It's often been said that the best things in life are free, and it's true. It's important to focus on non-material things; friends, family members, and activities that bring you happiness. The challenge for some is developing an understanding of what it means to be happy. Unfortunately, some people convince themselves that they don't deserve happiness and accept their circumstances far too easily. They may even subconsciously sabotage their efforts to achieve happiness. The truth of the matter is that happiness, like many other things in life, needs to be nurtured.

What Makes You Happy?

Each of us is built differently, so what makes *you* happy may differ from someone else. Spend a few minutes each day thinking about the things that make you happy. These few minutes will give you the opportunity to focus on the positive things in your life and can help lead you to continued happiness. It's also important to take some time each day to do something nice for yourself. Whether you treat yourself to lunch, take a long, relaxing bath or simply spend a few extra minutes on your appearance, you'll subconsciously put yourself in a better mood. Finding the humor in situations can also lead to happiness. While there are times that require you to be serious, when it is appropriate, find a way to make light of a situation that would otherwise make you unhappy.

Surround yourself with happy people. It's easy to begin to think negatively when you are surrounded by people who think that way. Conversely, if you are around people who are happy, their emotional state can be infectious. When something goes wrong, try to figure out a solution instead of wallowing in self pity. Truly happy people don't allow setbacks to affect their mood because they know that, with a little thought, they may be able to turn the circumstances back to their favor. Finally, it is important to understand that you deserve happiness. If necessary, tell yourself each day that you deserve to be happy and remind yourself what steps you'll take, other than spending beyond your means, to achieve the happiness you desire.

Life in the Age of Advertising

In addition to helping make us aware of specific goods that are available to us, marketers and advertisers exist to help us part with our hard-earned money. That's what they're paid to do, and they've become quite good at it over the years. Several well established advertising methods take advantage of the same compensation tendencies we discussed earlier, and by incorporating these principles into their advertisements, marketers are able to convince us to buy products we can't really afford or don't truly need, or both. As sophisticated adults, we can identify and appreciate the techniques that advertisers use, though we still often fall prey to them.

The goal of advertising is to provoke an emotional response in consumers. To achieve these responses, advertises brand their products to take on a grander association. For example, thanks to a series of effective ad campaigns, many Americans of a certain age associate Coca-Cola with Christmas. Each December, Santa Claus would drive his sleigh through the living rooms of America with a Coke in hand and a twinkle in his eye. Coca-Cola's ads took sugary water and transformed it into a staple of American life. Advertisers take this approach because much of our decision-making is influenced by our subconscious thoughts. Instead of Coke, we see Christmas.

As we get older, advertising and other forms of marketing take aim squarely at the range of emotions and insecurities we're prone to as adults. Fear, envy, lust, inadequacy – the full spectrum of feelings and conditions that arise from unfulfilled needs – are the focus of ads that target adults and their wallets. Most of the images we're inundated with on television and in magazines show people living the lives we think *we* should be living. Cosmetics, moisturizers, hair-growth formulas, wrinkle creams, self-help books, diet pills, sports cars, jewelry and alcohol are just a few of the products that are specifically marketed and sold to make us feel like a better, more beautiful or more successful person. Instead of remembering that our self-worth isn't dependent on these products, we buy into the notion that our "imperfections" need to be corrected, spending significant portions of our income every year trying to do so.

We've already mentioned it briefly, but let's look a little more deeply into the sense of **entitlement**. It is difficult for many of us to watch as our peers (or worse, *younger* adults!) are paid more than we are for the same forty-hour work week. Of course, their jobs may be more difficult or dangerous or require education that we didn't pursue, but, as our emotional impulses tell us, *we worked forty hours, too! We want the same things they've got!* It looks childish on paper, but the unconscious notion that we're *entitled* to buy something beyond our budget, simply because we have a job, is a very real factor in many spending decisions.

So What?

Is it so bad to treat yourself or your family to something nice every once in a while? The obvious answer to this is no - as long as you can afford to pay off that indulgence within a few months. No matter how many times you are tempted to rationalize your spending by repeating to yourself that, "It's only money," you must remind yourself that spending recklessly in the short term will hurt you over the long term. For example:

If you use credit to purchase something beyond your budget, you must calculate the interest that you'll pay for the privilege of borrowing someone else's money. Let's say you charged $1,000 on your credit card. At 15% interest and making only minimum payments, you would repay $1,758. That's an additional $758 that you paid in interest that could have used for other things.

If you use your savings to make the same purchase, you'll have to calculate the loss of potential wealth you could have built by leaving these funds in savings. Let's say you take $1,000 out of your savings to purchase the item. Earning 2% interest from the bank, that money would have grown to $1,456 over 20 years. Not great, but not bad, either.

As you can see, the cost of trying to obtain something we believe will make us happy can place our financial future in jeopardy. Perhaps one reason these decisions seem logical to us is that, for the vast majority of our lives, we're inundated with reasons to spend our money.

Eventually, our resistance may wear down, and we adopt some of these reasons as valid – *without thinking*. This may be why it's so hard for many of us to picture ourselves **saving**. We've been taught and conditioned to *spend*. Saving is the exact opposite of spending, so it seems difficult and often feels uncomfortable. *It simply doesn't come naturally to many of us.*

The point of all this is that you need to *learn about yourself* when establishing a financial plan. It's important to examine your spending habits, to evaluate not just what you're spending your money on, but *why* you're spending money on these items. This process will allow you to understand the difference between your individual wants and needs. This is not to say you should *never* buy things that you simply want but don't need. It's simply a reminder to be sensible about your spending. Many of us could eliminate a significant portion of our unwarranted spending if we'd just take the time to ask ourselves, "Is this something I truly need or something I simply want?"

Changing Your Financial Life

Although you can find a wide variety of personal finance guides and other self-help books, the key to financial success is probably already inside you: *You not only have to want to succeed; you have to be willing to sacrifice to achieve your goals*. When I was a boy, my grandpa told me much the same thing, though it took me a while to appreciate the soundness of his advice. At the time, I was dissatisfied with some of the personal choices I had made, and, as was often the case, my grandpa was the one who lent a sympathetic ear. He told me simply, "If you don't like your life, change it." It's a simple concept, but I've been able to apply it to my personal and professional life with some success. And I'm not the only one.

A short time ago, a friend shared a story with me that I think epitomizes the value of sacrifice. Some years back my friend befriended his local 7-11 cashier, who was desperate to escape the drudgery of the store and live life on his own terms. The financial challenge seemed enormous. How could he retire early and get out from behind the counter? As it turns out, he didn't need a financial planner; he simply needed to look at his own resources and capabilities to find the answer. The first part of the solution required a drastic attitude change. The cashier didn't feel he had the time or ability to learn a new skill set so he could find a different job, so he decided to work harder at the job he already had. But that didn't seem to make his goal any more obtainable. Here's where the sacrifice came in. Rather than continue to feel sorry for himself, he worked seven days a week for nine years straight, applying his well-developed work ethic and principles to build the financial cushion he dreamed of. Not only did he work hard, he also started living far beneath his means. He rented a smaller apartment and saved just about all of his disposable income. Sure enough, at the end of the nine-year period he was able to retire on his own terms. While this is a story of extremes, it still teaches a powerful lesson. In order to bring about change, the cashier examined his situation objectively and decided to make the most of his resources - in this case, his capacity for hard work - even if it meant making significant personal sacrifices to achieve his goals. By doing so, he set the stage for financial success.

Financial success can be attributed to challenging one's boundaries of comfort. If you keep doing what's ordinary, your results will probably be just that -- ordinary. So how can you do something extraordinary? Here are a couple of tips.

- **First, educate yourself.** Naturally, as a personal finance educator, I agree with this

100%. Before setting out to achieve a goal, look how others have achieved something similar and find out how they did it. You have to become familiar with the goals that you want to achieve. If you want to own a home, study the housing market. If you want to invest, study the stock market.

- **Second, team up**. Find someone who's on the path you want to pursue and have a conversation with them. In the era of social media, this is easier than ever. In my time online, I've met a number of people via social media whose insights I find to be both valuable and necessary for growth.
- **Third, create a plan.** Following a well-defined path often makes it easier to bring about change. In doing so, you create accountability. The benefit here is that this sense of accountability will help motivate you to reach your goals.
- **Finally, take small steps.** You need to be able to walk before you can run, and taking small steps if you're contemplating significant changes can dramatically improve your chances for success. Even though a task may seem difficult, breaking it down into smaller steps usually makes it easier to achieve. Eventually, all your small steps will culminate in the achievement of your goal.

Take a moment to ask yourself what your financial goals are, and how you might go about reaching them. Working seven days a week for nine years probably won't be on your list, but what *can* you do today to change tomorrow? The answers may surprise you, and don't be afraid of a little self-sacrifice.

Becoming Financially Literate In the Age of Technology

Imagine visiting a doctor for pain in your arm and, instead of performing an examination, your doctor provides a generic course of treatment – the old "take two aspirin and call me in the morning" routine.   This is essentially the same situation you run into with many so-called financial gurus. You give them some *specific information* about your situation, and they provide overly generic advice, which works *most* of the time. That's not good enough, particularly with the challenges we're facing in today's economy.

First, let's take a look at the definition of a "guru." According to the dictionary, a guru is a teacher - an intellectual guide in matters of fundamental concern. Do the personal finance celebrities we see on television qualify as teachers? Granted, their advice *is* usually based on sound financial principles: High interest rates equal greater cost in the long run; budgets work when they're created properly and reviewed regularly, and so on. That kind of information is valuable, but it falls a bit short in the guidance department. In order to *guide* an individual, you need to know where they're coming from, where they are right now, and where they're trying to go - financially speaking, of course.

Who's the best person to guide you in your financial situation? You are. Granted, you may need a little help getting started; however, there are thousands of not-for-profit agencies that offer the public free financial analysis. Speaking with a certified credit counselor will help you establish an initial game plan, as well as identify the information you need to know for your financial situation. Once you know where you're coming from, and where you are at the moment, you can use a host of resources to plan your financial destination.

The Internet is a fantastic resource for learning everything you need to know about money. Leading the way are a couple of fantastic websites that use everyday language to discuss a variety of personal finance topics in satisfying detail. One of the first places you'll want to bookmark is *360° of Financial Literacy*, a program offered by America's Certified Public Accountants. The website provides advice on the financial decisions you need to make throughout each one of your life stages. Everyone from tweens to retirees can find practical information within a few clicks of the mouse. *MyMoney.gov* is similar to 360° in that you can access financial categories relevant to your life stages; however, the website provides a greater amount of information about consumer rights. It also describes some popular financial scams you'll want to avoid. These are only a sampling, of course, so I recommend Googling the term 'personal finance websites' and taking a few for a test drive.

The Internet is also home to thousands of fantastic personal finance blogs that provide practical information about how to live frugally and manage your money wisely. We'd be here all day if I mentioned each and every website, so I'm going to share just a couple of blogs I find to be particularly helpful. The first is from Liz Weston, a personal finance columnist and author. At *AskLizWeston.com* you'll learn timely finance facts and tips that can help you get out of debt and build significant savings. *The Simple Dollar* is another great site to help you learn about money. The blogger reviews finance books, websites and posts a lot of helpful savings advice. Finally, *Spend on Life* covers a wide array of topics submitted by bloggers all over the world. Visit the blog to learn about bankruptcy, debt collections, student loans and mortgages. You might even find a few new bloggers to follow. Again, these are only a few tips about using today's technology to your advantage. I encourage you to discuss more about becoming your own financial guru with your certified credit counselor.

Developing a Spending Plan

The single most important thing you can do to ensure a strong financial future is develop a Spending Plan. Your specific plan will be directed by the goals you develop and the financial resources you have available to reach them. While the thought of creating a comprehensive plan may seem overwhelming, it is surprisingly easy and will help ensure that you're on track to achieve your goals. With an effective Spending Plan in place, you'll be better positioned to manage all of the various aspects of your finances, including your spending, use of credit, saving, and investing.

Plan Construction

Development of a personal Spending Plan involves several painless steps. Each one is important and all must be coordinated if the financial plan is to succeed. The following are the essential steps of the process:

1. *Evaluating the current situation: "Initial Spending Assessment"*
2. *Identifying "wants" and "needs"*
3. *Discussing options and adjusting spending accordingly*
4. *Tracking spending - Creating a Comprehensive Budget*
5. *Establishing and implementing short- and long-term goals*
6. *Reviewing and modifying your plan when necessary*

<u>Step One</u>: Evaluating the Current Situation

Before determining a reasonable course of action, you must have a clear picture of your current situation. This is accomplished by conducting an Initial Spending Assessment. The goal of this step is to identify where every dollar goes after it leaves your wallet.

<u>Initial Spending Assessment</u>

Some may find the budgeting process intimidating, but understanding where your money is going is the cornerstone of any financial plan. After you've identified each expense, you'll have the information you need to make sound decisions about your financial goals. There are two steps in the Initial Spending Assessment. In our first step, you'll create a "Gut-Check" budget to get a sense of how much of your income is going into several specific categories of spending. Though mindful of the fact that each of us has his or her own spending needs, we'll also make recommendations about appropriate percentages of your income that may be dedicated to each category.

A note about net and gross income: There are some advisers who recommend that people use their gross income when developing a Spending Plan. Gross income represents a person's income before taxes and other deductions are taken out. The problem with using gross income is that it doesn't offer a true representation of someone's finances. If a person commits more than 30% of their earnings to satisfy their various deductions, they're only bringing home 70% of their gross income. Under these circumstances, it would be foolish to construct a budget or Spending Plan using gross income amounts. Cambridge recommends that an individual use their net income, or use their net income, or take-home income, for such calculations. This is the money you actually control.

Entering Income and Expense Data

There are two key elements that drive a Spending Plan - income and expenses. On the worksheets we've provided in this booklet (and which are also downloadable for free on our website), begin by entering your net income, which includes your salary as well as any additional forms of income such as alimony, child support, commissions, etc.

Next, gather as many of your bills as you can, including credit card statements, receipts for groceries, gas, or anything else that you bought with cash. To review additional expenses, it would also helpful to have your checkbook register available. If you're creating a Spending Plan for the first time, it may be unlikely that accurate records have been maintained, and that's fine. The goal of conducting an Initial Spending Assessment is to obtain a sense your current spending habits. If you haven't maintained proper records, don't worry, you can make "best-guess" estimates when necessary.

Also, be sure you account for "budget busters." Budget busters are irregular expenses that can catch us off guard. For instance, your annual insurance premiums or quarterly tax bills are items that can disrupt your plan. When you're devising your Spending Plan, be sure to give some thought to these expenses so you can account for them in your budget.

Gut Check Budget Recommended Spending

Spending generally falls within six categories in a typical budget. Cambridge recommends that each category take up a certain percentage of monthly income, as outlined below:

- Life: 17%
- Debt: 12%
- Home: 40%
- Other: 6%
- Savings: 10%
- Travel: 15%

Let's review a sampling of some of the items that are included within each category. (For a full listing of line items, please review the Spending Plan sheet included in this guide.)

LIFE

The items within the Life category include common living expenses, including clothing, childcare, fast food, groceries, computer downloads, subscriptions, and entertainment items such as monthly cable payments. All health care related expenses are also included in this section.

DEBT

The *Debt* category is fairly self-explanatory. Please note, however, that in addition to your credit cards, gas and store cards, as well as any other loans, there are some items that you may not readily identify as debt that should also be listed in this category. For instance, obligations such as child support and alimony should be listed here. (If such payments are directly deducted from your paycheck, omit them.)

HOME

All expenses incurred in the maintenance of your home or apartment will be included in the *Home* section. Common expenses can include rent or mortgage payments, any insurances associated with housing, household utilities, payments for household furnishings, as well as your cleaning and maintenance products. Homeowners will also want to include any payments for water, sewage and garbage removal.

OTHER

The *Other* section is essentially a catch-all area of the Spending Plan, and will contain a variety of your everyday expenses, including personal care products, birthday gifts, school tuition fees, Internet service, cell phones, alcohol or tobacco products, the costs of your hobbies, and just about anything else that does not fit into the other categories of this plan.

SAVINGS

Although you may not be saving money at the moment, Cambridge recommends that people commit 10% of their earnings toward savings. Achieving this goal may take some time before it comfortably fits into your budget, but it is important that you strive to commit at least some portion of your earnings to this category. Even if it’s just one percent, it’s a start.

TRAVEL

In the *Travel* category, list your personal and public transportation expenses. Remember to include any auto insurances, vehicle payments, parking fees, bus passes, car or motorcycle registrations, maintenance and repair costs, as well as expenses for fuel.

Your Gut Check May Feel like a Punch to the Gut

At the conclusion of this step, many people discover that their spending doesn't match our recommendations. That's fine! Remember, the point was to know where you are, so a plan can be developed to get you where you want to go. One of the goals of this analysis is to reveal those spending categories that need adjustment. Even before you finished making your entries, you probably identified several expenses you can cut back on. The next objective will be to use this information to create a revised, comprehensive budget, based on actual expenses. No ballpark figures allowed!

Cutting Expenses

The importance of a revised, Comprehensive Budget is that allows you to further scrutinize expenses. We all make little purchases here and there, but their impact on our budget can be significant. For instance, when I completed my first Initial Spending Assessment I saw some obvious, and not so obvious, reductions I could make. I knew I needed to cut back on take-out food and going out to the movies so much, but one thing in particular shocked me - the amount I spend on coffee. Yes, I know the coffee example is an old one; however, it's still relevant and very powerful. I may never have noticed it merely by conducting my Gut Check Budget, which is why the Comprehensive Budget is so important to the planning process. After crunching all the numbers it became apparent that I was spending a *$100 a month, or $1,200 a year, on coffee*.

Many of us spend significant amounts of our hard-earned money without even a second thought. Needless to say, $1200 got me thinking. Sure, I love coffee, but the money I was spending could be put to better use in reaching my goals. I could pay down my debt, build savings, apply the funds to my student loan payments, or add to my retirement account. So, I started thinking of ways to have the best of both worlds; living without coffee was not an option, but neither was wasting my hard-earned money to that extent.

My solution was simple; purchase a coffeemaker and the necessary ingredients to make my own coffee at home. Here's how it worked out for me:

- Coffeemaker: $20 (one-time cost)
- Coffee: $6 (each month)
- Cream: $2.50 (each week)
- Sugar: $5 (every three months)

Since the coffeemaker is a one-time expense, let's take it out of the ongoing cost. Over the course of the year, I now spend approximately $222, *a savings of $978*. I was able to maintain my lifestyle and contribute to my financial well-being at the same time.

Obviously, each individual's Initial Spending Assessment will yield different results, but the point is the same - each person will get a broader understanding of just where their money is going.

<u>Step Two</u>: Identifying Wants and Needs

In order to effectively determine the line items that can be adjusted, you must examine your expenses in terms of "wants" and "needs." "Needs" are the essentials, the basics of life, including food, clothing, shelter, and anything else that you determine that is absolutely necessary to live life. "Wants" are everything else.

Categorizing wants and needs is a subjective exercise that is dependent on a variety of factors. For example, if you live in New England you may *want* a snowmobile for enjoyment. If you live in Alaska, you may *need* a snowmobile for basic travel. This is, of course, an extreme example; however, it is helpful to put yourself in a similar mindset for analyzing wants and needs.

The following is a good exercise to help identify your wants and needs. On a piece of paper make three columns; one for needs, one for wants, and a final column for items that may be difficult to categorize. Any expenses that initially find their way into the undecided column should be readdressed once the rest of your expenses have been assigned. Remember, every item we spend our earnings on can fall into either the *need* or *want* category. The goal of this soul-searching is to help you identify where your earnings are committed, and whether they're really that important to you.

<u>Step Three</u>: Discussing Your Options / Adjusting Spending

Many families feel that discussing their finances is taboo, and would do almost anything to avoid a conversation on the topic. When you're ready to refine your Spending Plan, it is important to include everyone who will be affected by the changes involved in the process. This step often proves beneficial, since an alternative point of view may be helpful as you try to reduce spending in specific areas of the plan. In addition, if they're active participants in the process, they'll be more willing to accept any adjustments to the Spending Plan that directly affect them. Once everyone is on board, it's time to implement the intended changes. Don't hesitate.

Savings: The Goal of the Initial Spending Assessment

The most important goal of developing a spending plan is to achieve savings. Once the initial assessment is completed and areas where spending can be reduced have been identified, it’s time to implement realistic savings. While it is Cambridge's recommendation that individuals strive to save 10% of their net income, we realize that this may not be achievable right away. If an assessment doesn’t immediately allow you to save 10%, then save 5%, or even 2% of your net income; after all, something is better than nothing! As time goes on, other measures may be put in place to help you achieve the recommended 10%.

Once the recommended percentage has been achieved, it should be maintained until a sufficient emergency fund has been assembled. An emergency fund for a single individual might contain 6-8 months’ of living expenses. An emergency fund for a family should contain 8-10 months of living expenses. The expenses to concentrate on are the essentials, including rent/mortgage, automobile and insurance payments, groceries, utility payments and anything else that is necessary as you try to recover your financial footing. Unfortunately, too many Americans still live from paycheck to paycheck, and maintaining this type of lifestyle only invites disaster. The truth is that anyone can experience a financial setback. The only way to be prepared for such events is to possess an adequate emergency fund. Therefore, putting your emergency fund together should be a top priority among your spending goals.

After a sufficient fund has been developed, your savings can be diversified. You can start saving for vacations, tuition, home maintenance, and any other goal you may establish.

<u>Step Four:</u> Tracking Spending – Creating A Comprehensive Budget

The best way to create an effective Spending Plan is to track your day-to-day, week-to-week, and month-to-month spending, moving beyond your initial, gut-check budget to a more refined, comprehensive document. Perhaps the biggest obstacle for individuals who want to move forward in the process is the absence of accurate spending data. While most of us how much we spend on rent and mortgages, car loans, credit card payments and utilities, very few of us can account for the little things we spend on. Your Comprehensive Budget will account for as many of these expenditures as possible.

<u>A Day in the life of Bob</u>

Let's imagine the fictitious day of Bob. Like most of us, Bob has a pretty hectic lifestyle. He's on the go from the moment he wakes until he gets home from work in the late afternoon. His schedule does not leave a lot of time in the morning, so he grabs breakfast on the run. Bob picks up a newspaper, a light breakfast and a coffee on his way to work. Because he doesn't have a lot of time in the morning, he buys a sandwich for lunch and grabs an afternoon snack at the office. To maintain his hectic pace, Bob typically buys an afternoon coffee for an extra burst of energy.

Many of us can identify with Bob's expenses. What's surprising is exactly how much all these trivial purchases can add up to. Bob's newspaper costs him $.50; his breakfast of a bagel, orange juice and coffee costs him $5.50. His daily visit to his favorite delicatessen costs $7.00. And finally, his afternoon snack and coffee costs $3.50. In total, these seemingly everyday expenses add up to $16.50. Since this is his daily routine, Bob spends $82.50 each week on the same items. Over the course of a month that would be $330, and $3,960 annually! Of course, Bob doesn't feel this expense when he's merely putting down two quarters for the newspaper, but a closer look at the annual numbers is clear evidence that a significant portion of Bob's income goes to items he pays very little attention to.

Tacking spending regularly is an easy mechanism for staying committed to your Spending Plan. When you track expenses from week to week and month to month, you'll have the data you need to make additional adjustments within your plan, creating a Comprehensive Budget that is a true reflection of your income and expenses.

The easiest way to track spending is to carry a small notepad and write down each item purchased. If you have a smart phone, you'll be happy to know that there is an app for that. No matter how you track your spending, you should total each week and compare it to your Spending Plan. As we've seen in the case of Bob, you may immediately notice that your incidental spending is high. Having this information allows you to refine your plan to get this type of spending under control. For instance, in Bob's case he may decide that he is going to get up a little earlier in the morning. With this extra time, Bob decides to eat breakfast, brew a pot of coffee so that he can bring a cup with him on his way to work, make lunch, and pack a snack. While these items still command a portion of his income, over the course of the year they will be *substantially* less.

<u>Step Five</u>: Establishing and Implementing Your Goals

Many people have specific financial goals they'd like to achieve. We will discuss goals in greater detail a little later on, but for now we'll focus on the basics. Goals can be categorized as either short-term (fewer than 12 months to accomplish) or long-term (beyond 12 months to accomplish.) Examples of a short-term goal can include purchasing a new TV or planning a family vacation. A long-term goal could be described as purchasing a home or saving for a child's education.

When thinking about goals and how you'll achieve them, it's important to ask the following questions:

- How much money will I need to reach this goal?
- Is this a short- or long-term goal?
- Will this fit comfortably into my Spending Plan?
- What additional information do I need to achieve this goal?
- What help, assistance, or collaboration do I need?
- What financial obstacles can block my progress?
- Is there a better way of doing things?
- Is my plan to achieve this goal realistic?

While all of these questions are important, the final question is arguably the most significant. There is nothing more frustrating than falling short of the goals you've set for yourself. Not only do you miss out on the achievement, it can shake your confidence. The exercise of goal setting is essentially a confidence builder. As you reach one goal, you're empowered to reach the next, and so on. So, one of the most important things to consider when you're developing a goal is the reality of achieving it.

Another important aspect is prioritizing your goals. There are probably some things that you need to do sooner rather than later. For instance, a family could be expecting a child and needs to furnish a room in a relatively short period of time. This goal would take priority over, let's say, purchasing a new automobile in a year. Therefore, when planning to reach both short and long-term goals, you must prioritize each according to the order in which you want to achieve them.

In addition, progress toward a goal should be reviewed periodically, especially if the end result won't be achieved for a long time. This allows you to monitor progress more easily, rather than feeling the frustration of the time that may remain until the goal is reached. Remember, goal setting is about confidence building. Each step of the way is another step toward meeting your goal. Each step builds confidence. Whatever system you develop, whether technical or basic, it should mimic the tracking of your daily expenses. For instance, if you commit $50 each week toward your goal, you want to keep an accounting of each installment, as well as a running total. You should also indicate how much more is needed to meet your goal. Let's imagine that our friend Bob has two short-term goals – purchasing a new TV for $400 and re-tiling his bathroom at a cost of $1,000. Based on his Spending Plan, Bob determines that he would like to re-tile the bathroom within six months, and that the TV can wait until after that is done. Each pay period Bob puts $42 toward his goal of tiling the bathroom and $12.50 toward the new TV. In tracking his progress, Bob feels a sense of accomplishment each time he reviews the money he has committed to reach one of his goals. Tracking the goals in this manner not only empowers Bob, but it also proves a valuable point. Bob realizes that he can achieve his financial goals because the process he's using is *proving* this to him every day. While he will undoubtedly be happy when he finally reaches each one of his goals, each time he commits his finances toward their achievement he receives a measure of satisfaction. By setting sharp, clearly defined goals, an individual can measure and take some pride in their achievement, without waiting until they're fully accomplished.

Step Six: Reviewing Progress

Once you've gained control over your finances, you'll want to ensure that you maintain an appropriate pace toward your goals. Cambridge recommends that individuals perform a Financial Check-up each four-month period using the information gathered throughout that time. To complete a financial checkup, simply follow the same steps used during an initial spending assessment. Periodically monitoring your financial progress will help you reduce or eliminate certain expenses and identify other areas that may require adjustments.

Goal Development

Your Spending Plan is an important guide to achieving financial results, *if* you use it properly. Whether you have a lot of money or just a little, a true measure of your financial success is your ability to use a Spending Plan to meet your goals. Imagine your financial goal as a destination you could travel to by car. To reach it, you'll need to make efficient use of your money as you prepare for the journey, and you'll need to set aside certain resources for use along the way. You'll get a tune-up, check the tires, pack some food, etc., and you'll also figure out how much money you'll need for gas and tolls during the trip, all before you leave the driveway. Achieving your financial goals should work much the same way, because attaining them depends on thoughtful preparation.

In addition to getting you where you want to go in life, goal development has benefits beyond simply achieving the goal itself. Properly developed goals can be incredibly motivating, and, as you get into the habit of setting and achieving them, you'll probably find that your self-confidence has increased, as well. By constructing a strong goal development routine, you can measure and take pride in the achievement of the goals you've set, in turn helping to ensure future financial successes.

The Seven P's of Goal Development

There are a few different formulas you can use to strategize your goals. For the purposes of this guide, we'll use the "Seven P's" approach. The goals that you set need to be *plausible*, and your plan to achieve them must be *precise*. To meet your goals, you must *prioritize* their importance and properly *prepare* for the steps you'll need to take for their achievement. Throughout the process, remain *positive* and maintain the appropriate *passion* to reach your goals. Finally, gauge your progress on *performance* and not on outcome.

Plausible

As mentioned earlier in this guide, developing unrealistic goals can have a negative impact on your financial plan, and on your well-being. For example, let's assume you want to purchase a new home within two years, and that you'd like to pay for it in cash. The particular home you're interested in is selling for $450,000. Your current employment as a teacher, with a modest income of $46,000, allows you to satisfy your obligations and have *some* discretionary income. The truth of the matter is that you would probably have a better chance of hitting the lottery without a ticket than buying the house for cash. Let's examine why this particular goal is not plausible.

While your income is sufficient to meet your immediate needs, it is impossible to save $450,000 for the purchase of this home in the timeframe allotted. Perhaps a more plausible goal would be to save for the down payment, let's say 5% of the purchase price. In total, you would need $22,500. In order to save this amount within 2 years, you would need to save $937.50 each month. Only you can assess if this is appropriate, and that's only after you've developed a Spending Plan to determine what discretionary income you would have to commit to the purchase. You may find that $937.50 is beyond your capabilities, and that's fine. You'll probably have to reassess the home you were looking to purchase and find one more modestly priced, so that you can build the down payment into your plan. The lesson here is, setting unrealistic goals can be harmful, as you may begin to lose hope of ever achieving your dreams. By developing plausible goals, you will not only increase your odds of meeting them, you will also help yourself maintain a positive outlook on the future.

Precise

The more specific your goal is, the more realistic your chance of success. By making the goal specific in nature, you'll "own" it. For instance, let's say your goal is modest: you'd like to buy a new couch. Instead of simply establishing the goal, go out and find the exact couch you intend to purchase. Once you've seen it and had the opportunity to take it for a test ride, you'll form a personal connection to your goal. You won't simply be saving money for *a* couch; you'll be saving for *your* couch.

Many of the people who contact us at Cambridge Credit Counseling share a common goal: getting out of credit card debt. This is an area where being precise can also be quite helpful. Let's visit with our friend Bob again to illustrate. Bob has three credit cards that he'd like to pay off, and he decides to make minimum payments on two of the cards while focusing the lion's share of his budgeted credit payments on one card. In doing so, Bob will create the discipline of committing funds toward debt repayment and receive the psychological benefit of achievement when his first card is paid off. Let's give our example some detail:

- Credit Card A: Bob is being charged 15% on a $900 balance.
- Credit Card B: Bob is being charged 13% on a $600 balance.
- Credit Card C: Bob is being charged 12% on a $500 balance.

In this scenario, Bob decides to make the minimum payments, plus a little extra, on credit cards B and C. Using his Comprehensive Budget, Bob identifies $100 that can be used to pay off his credit card debt. He pays $25 a month toward credit cards B and C. He then commits $50 a month toward the repayment of credit card A. While the repayment of credit card A would have taken as much as five years if Bob made only minimum payments, this method would satisfy the debt in 19 months. Once this has occurred, Bob may then take the $50 and apply it toward the next card until it's paid off, and so on. Not only does this method reduce the amount of interest Bob would repay, it also shortens the timeframe of debt repayment and provides satisfaction in achieving a goal.

Prioritize

We talked earlier about short- and long-term goals. Short-term goals are those that can generally be accomplished in under 12 months. Anything longer can be considered a long-term goal. But while categorizing your goal in this way is necessary, it's more important that you develop the order in which you'd prefer to achieve them. This allows you to avoid feeling overwhelmed when you have multiple goals and helps you focus your attention on the most important ones.

Preparedness

In order to meet the goals you've set, you need to be prepared. To do so, you should ask yourself some questions:

- Why is this goal important to me/my family?

- How much money will I need to reach this goal?
- Will this fit comfortably into my Spending Plan?
- Have I established a realistic timeframe for reaching my goal?
- What additional information do I need to achieve this goal?
- What help, assistance, or collaboration do I need?
- What financial obstacles could block my progress?

A good way to help prepare yourself to accomplish your goals is to create a “Goal Book.” Commit one page to each goal that you set. Write out the questions listed above, along with your answers for each. This will help you to better visualize your goal and help you to determine how plausible each will be to attain. If you find it helpful, place a picture of your goal on the page as a way to “own” it. You can also track financial progress made toward completing the goal on its designated page. For example, if the couch you were looking to purchase costs $1,000 and you commit $25 of each paycheck toward its purchase, write down each deposit and subtract it from the total price. Remember, achieving your goals can be very empowering. Your self-confidence should get a boost every time you review your progress.

Positive Thinking

Always remain positive about achieving your objective. You *will* reach your goals; it’s simply a matter of time. Shakespeare wrote in *Hamlet* that “there is nothing good or bad but thinking makes it so.” The Bard knew that attitude is everything. Sure, you may face challenges on your way to reaching your goals, but oftentimes that’s all they are - mere obstacles that you must rise above to reach your destination. Maintaining a positive attitude will help you overcome adversity, not just in accomplishing your goals, but in many other aspects of your life.

Passion

Anything worth having is worth working for. Each goal you set is important to you, and the passion that drives you toward the fulfillment of that goal is important, too. Just imagine how you're going to feel when the goal is finally reached. A sense of accomplishment is one of the most powerful feelings that a person can have.

Always keep the achievement of each goal in mind. If you ever find your motivation weakening, go to your "Goal Book" and read the pages you've dedicated to each of your goals. It should re-ignite your passion for achievement and provide you with the energy and attitude lift you need to persevere.

Performance

At times, a person's enthusiasm for a particular goal may falter because it's far off in the future. We are a "need it, have to have it now" society, and the slow pace of goal attainment can be challenging. Yet, in life, all you have is time. Yes, you could use credit to meet your goal, but then you have to contend with debt, and that's not always the best option. One of the best ways to keep yourself energized is to establish financial milestones for each of the goals that you have. For instance, if your intention is to set aside $1000 for a couch you're looking to buy in eight months, set some savings milestones to achieve along the way. Let's say you're paid bi-weekly. Set a milestone to save $62.50 of each paycheck to meet your goal. When you find yourself wavering, take a look at your progress. For instance, if you find yourself discouraged after 3 months of savings, take a look at all you've achieved – in that time you've saved $375, more than one-third of what you'll need. Even though you have a ways to go, you *have* achieved something already. Periodically acknowledging your progress will help keep you moving forward.

Be Prepared for the Unexpected

One of the few constants in life is change. Such unpredictability invariably leads to the development of additional goals. That's why it's important to revisit your objectives regularly. Not only can you review your progress, you can examine the appropriateness of your goal to your changing circumstances.

Also, remember that life happens. Things may come along that temporarily prevent you from reaching your goals, but it's important to get right back on track as soon as you can. By developing a solid Spending Plan, establishing an Emergency Fund, and remaining committed to your goals, you can live a happy and rewarding life, despite the roadblocks.

Regaining Financial Control

Some of you may be in good shape after you construct your Spending Plan and may have no problems meeting your financial obligations. However, others may find that their plan has some flaws – particularly if you were already behind on your bill payments before you created your plan. In that case, you'll have to work a little harder to gain control of your situation.

Perhaps one of the most frustrating aspects of regaining control of your finances is dealing with bill collectors. These individuals have a notorious reputation; deceptive and abusive practices are not beneath them. The good news is that these can be avoided. People often fail to realize that if they keep an open line of communication with a creditor they've fallen behind with, they may be able to avoid seeing the account go to a collection agency. Most creditors do not wish to write an account off as bad debt, but they often have no choice when consumers avoid communicating with them.

When you realize that you will not be able to make any of your bill payments, the first thing you should do is call your creditor. Avoiding the situation will only make things worse, as your account will only fall further into delinquency. Creating a dialogue with your creditor allows you to work with them to develop a plan to take care of your arrearage and avoid the stress of collections.

In the development of a strategy to repay outstanding amounts, you must remain realistic about your financial situation. You'll want to establish arrangements that you can maintain, and must not make any promises you cannot keep. If you can afford $20 each month, tell your creditor that. If you make a promise to pay $100 and only send the $20, you are jeopardizing the ability of the creditor to work with you. In time, the account will only go to collections because you didn't maintain the agreement.

If you fail to contact the creditor, they will contact you. Generally, you will receive correspondence from them within the first few weeks of your missed payment, although some creditors will contact you much sooner. At first, these letters will be polite, offering a reminder that your payment has not been made; however, over time, these letters will increase in their intensity. This of course depends on the type of creditor you are dealing with. Smaller companies may be aggressive from the beginning, while others are conscious that you may be a customer again in the future and won't want to tarnish their reputation with you. In any case, the first thing you should do when faced with these correspondences is contact your creditor immediately. Let's face it, individuals don't make late payments because they have too much money. They're typically in a financial bind of one sort or another. By communicating your situation honestly to your creditor, you may be able to keep the account with them until you're back on your feet. Even if you can't afford to send them a great deal of money, call them to inform them of the challenges you're facing.

Prioritizing Bill Payments

When developing a plan to deal with outstanding obligations, you must prioritize your bills relative to their importance in your life. It is perhaps human nature to want to pay the creditors who are applying the most pressure, but this may not be in your best interest. Of course, all of your creditors will want to receive payment, but you must take care of your needs first before you can satisfy theirs.

Secured Debt vs. Unsecured Debt

A general rule to follow is to assign the highest priority to bill payments that are secured, and a lesser priority to those that are unsecured. Secured debts are debts with collateral that may be seized for non-payment. Typical secured debts include mortgages, car loans, and loans secured by household items. Should you fail to make payments on your secured debts, the creditor has the right to take the collateral to satisfy the remainder of the loan.

Unsecured debts include items such as credit cards, legal, and medical bills. It is important to realize that non-payment of any of your obligations can have an effect on your credit profile, but you can only do so much when trying to regain control of your finances. You can worry about reestablishing your credit rating after you've stabilized your overall financial situation.

Developing Your Repayment Plan

Understanding the importance of satisfying your secured debt is important, but there are many more necessities to take into consideration; after all, making your boat payment is one thing, putting food on the table is another matter all together. Regardless of the severity of your financial setback, you must look at your life essentials as high priority bills. You must also remain conscious of the need to periodically reevaluate the amount of money you're paying for these essentials.

Often, individuals faced with a financial crisis fail to make adjustments to their spending habits. If you've lost your employment, do you need to continue spending $125 every month for cable? Better yet, should you continue to eat out? The answer is no; however, people can live in denial about the challenges they face. First and foremost, "belt tightening" is in order to help you navigate the time ahead.

Payment Priority

Your mortgage should get first priority because a delinquency here can result in multiple problems down the road. Not only would you risk losing your home, you would seriously jeopardize your credit rating. If you rent, you may get a bit more leeway from landlords, but you should still give precedence to this payment. If you're a homeowner, be aware that foreclosure proceedings can start after as few as two missed mortgage payments.

Utility companies may offer budget plans, installment programs or other accommodations. If you need to, contact the Salvation Army, the United Way and other social service agencies for help with food and clothing. Lower-income women who are pregnant, nursing, or those with children under age five may qualify for WIC, a Department of Agriculture nutrition program that provides things such as milk, cereal, cheese, and other food items. Auto finance companies and credit unions may allow hardship cases to defer a payment on an auto loan or lease. Interest will continue to accrue, however, and some lenders may charge an extra fee for this option.

Savings

As mentioned earlier, savings is perhaps the most important aspect of your Spending Plan. All of Cambridge's counselors have heard accounts of how difficult it is to save money. Each person's rationale differs, but the most common argument I've heard is, "I don't make enough money to save." Understandably, each of us has different circumstances. Some of us earn modest livings, support families, manage high levels of debt, and possess little in the way of financial sophistication. However, our experience has shown that there is almost always room for savings. There are mountains, some in the distance, and others right in front of us, that must be conquered. And I learned well before my career as an educator that Mt. Financial is the first summit *I* had to conquer.

First, let's dispel the myth that only people who earn high incomes can save. In a report on wealth and savings, researchers Steven F. Venti and David A. Wise found that some high-income people wind up with little wealth, and some low-income people accumulate a great amount. It is not the income level, or circumstance, that makes the difference, but how much people *chose* to save. Sure, higher earnings lead to a greater potential for savings, but the real key is lifestyle. Trust me, I've gone through the pain of worrying about how I will pay an electric bill, or deciding how I can afford to get my brakes repaired. I've experienced the agony of realizing I was unprepared to meet my obligations because of my financial situation. My obstacles were the same as the ones many of you face now – I earned next to nothing, I had no savings, and the stress of dealing with my obligations left me feeling hopeless. However, my experiences lead me to an obvious conclusion -- it is better to *live* without, than *be* without. I decided that even though I made minimum wage, a portion of that had to go to savings. That meant I had to make some very different choices in the way I spent my earnings.

Much has changed in my life, but one thing has remained the same – I am frugal, and I'm not alone. Over the last few years, I've read countless stories of people who achieved extraordinary savings while earning modest incomes. There is the story of the retired social worker who bequeathed $1.3 million to charities in her community. She drove a run-down car, lived in the same house for 40 years, yet she had the financial wherewithal to travel throughout Europe and build impressive wealth from a seemingly unrewarding income. Then there is the farmer who appeared to live in the squalor of a mobile home surrounded by rusting farm equipment who willed $2 million to his church. And finally, I read about a teacher earning a mere $28,000 a year who, upon his death, donated $2.1 million to his *alma mater* for the establishment of scholarships to benefit African-American children. The common thread in these stories is the belief that money is merely a means to an end. Instead of allowing money to control their lives, these individuals controlled their finances. They could have looked at money as a fleeting resource, but they didn't. These individuals understood that their time, effort, and capacity could accomplish much more.

You can build wealth, just like these average folks, by taking command of *your* earnings. Each week, pay yourself first – *you* worked hard, and *you* deserve it! As I've mentioned, it's best to commit 10% of your earning to savings, but start out with a smaller percentage if that's more comfortable. The point is, save something. If we look at where our money is going right now, each of us can probably identify 5% to 10% that can be redistributed to savings.

Building Wealth

When we talk about savings, we're really talking about building wealth. You can still choose to sock your money away under a mattress, but that does little to make your money grow. There is a logic in business that the value of a dollar today is greater than its value tomorrow. Why? Well, the purchasing power of the dollar decreases over time. This is attributed to inflation. Essentially, inflation occurs when the prices of goods and services rise. Historically, inflation has grown at a rate of roughly 3% each year. Let's look at an example. Say you bought a soda today for $1. Next year that soda may cost you $1.03. In ten years that soda might cost you $1.30. This will hurt you if you aren't getting a greater return on the money you have in the bank. If you were earning 2% interest, your money would be growing at a rate 1% behind inflation. If you saved the dollar for soda and were earning 2% interest on it, next year that dollar would be worth $1.02; in ten years that dollar would be worth $1.20.

Growing Your Money

Let's take a look at some of the basic concepts of wealth building.

COMPOUND INTEREST

Compound interest is a powerful tool you can use to make your money grow. It involves earning interest on interest you've already received. Let's say you put $1,000 in a savings account that pays 5% interest. At the end of the year, you'll have received $50 in interest. Now you have $1,050. ($1,000 x 5% = $50). In the second year, you will earn 5% on $1050, or $52.50. Notice that your money grew faster. You made $50 in the first year, and $52.50 in the second. This is how compounding works. The longer the money stays in the savings account, the faster it will continue to grow, so it's a good idea to start a savings plan as soon as you can.

THE RULE OF 72

Let's assume for a moment that you had an "extra" $1,000 and decided to put it into an interest-bearing account. Even if you never made another deposit, in a certain amount of time that money would double. That's the beauty of compound interest. By using something called the Rule of 72, we can see how long it will take to double your money. All you have to do is divide 72 by the interest rate the account was paying. Sounds simple, so let's try it out. If you had an account that pays 4% interest on your money, the math would be as follows: 72÷4 = 18. It would take you 18 years to double your money. Not bad, but you can do better!

RISK AND RETURN

There are many ways to save money and build wealth, some of them riskier than others. The more risk, the more potential you have to build wealth. As an example, let's compare two ways to make your money grow: a savings account and a stock. A savings account has very little risk; the money you put into it is insured by the FDIC and there is very little chance of losing it. On this type of account you would probably earn about 1.5% interest. Stocks, on the other hand, are *very* risky. There are many factors that can cause you to lose your money. Because of the high risk, over time you might be able to earn an average of between 10% and 11% in interest.

By using the Rule of 72, let's see how long it would take to double $1,000 in a savings account versus investing in a stock. In a savings account you would earn 1.5% interest, so you would do the math as follows: 72÷1.5 = 48 years. Investing in a stock, you would earn about 11% interest, so: 72÷11 = 6.5 years. As you can see, more risk definitely equals more return.

DIVERSIFY

Putting all your eggs in one basket is not a good idea. With the high risk of investments, you really don't want to put all your cash into the stock market. Why? Well, the market is volatile and no stock is a sure thing. If you put all your money there and lose it, you might be ruined. By spreading your money out between both low- and high-risk items, you avoid losing everything if your investment goes bad.

Ways to Make Your Money Grow

There are a lot of ways to make your money grow. The following are a few of the more popular options.

BONDS

When you buy a bond, you are lending money to a corporation or government. In return for loaning them money, you get a specified interest rate which, depending on the type of bond, is paid either at specific periods during the life of the bond or when the bond matures. These are generally long-term investments.

MUTUAL FUNDS

A mutual fund is an investment corporation that pools together investors' money to purchase stocks and bonds. The advantage offered by this type of investment is that it is diverse and not dependent on the performance of a single stock or bond. The mutual fund itself does the diversifying for you for much less of an investment than if you were buying each stock individually. A mutual fund is managed full-time by a Fund Manager who decides which stocks to buy and sell every day. The manager's job is to maximize the return from your investment while maintaining the appropriate risk level.

STOCKS

By purchasing shares of a stock, you become part owner of the company. This does not mean you can walk in and use the executive washroom, though. If the company does well over time, the value of the stock should go up. If you sell the stock, you make a profit. Some companies pay their shareholders' dividends, which are percentages of their earnings. Stocks are definitely a long-term investment.

Walk Before You Run

When you're entering the world of savings, you want to start off with the more common vehicles until you become a seasoned saver. Lots of things can happen, and you don't want to tie up cash you may need in an emergency. As we've explained, some savings vehicles penalize you for early withdrawals, and others are more appropriate for long-term goals. In essence, this is what's referred to as liquidity, or how much can you get your hands on in a crisis. A savings account is more liquid than a stock because you can generally get your deposits on demand. With a stock, you would have to sell your shares, and more importantly, sacrifice future earning potential. Once you've saved up a good financial cushion, then and only then, consider moving into more aggressive savings vehicles. Then, if something comes up (the car needs a new transmission, your stove stops working, etc.), you'll have easy access to your cash.

Credit Reports

Your credit report is reviewed by lenders to assess your creditworthiness. Are you a good candidate for a loan? Based upon the review of your reports, a potential lender will determine if they want to extend financing to you, and, if so, at what interest rate. Over the last decade, usage of credit reports has expanded dramatically. These days, it is not uncommon for your report to be reviewed when you apply for a job, for an apartment, and even for an insurance policy. With so much riding on your reports, it's important that you know how to read them, that you understand the signals your reports might be sending, and that you are aware of the process for fixing mistakes when they appear.

The Fair and Accurate Credit Transactions Act (FACT Act) allows you to receive one free credit report each year from each of the three major credit bureaus - TransUnion, Experian and Equifax. With so many important aspects of your life relying upon the accuracy of your credit report, is important to review your reports annually. Credit reporting agencies are required to furnish accurate information regarding your profile; however, that does not necessarily mean your reports are correct. The accuracy of the items reported by these agencies is reliant upon their subscribers - credit card companies, lending institutions and even the court system. Should one of these subscribers provide information that is incorrect, it will not be detected by the credit reporting agency. Do you owe Sears $120.00 or $1,200.00? The credit bureau doesn't know. They can only add what Sears may tell them to your report. It's up to you to find the mistake, document that you're correct (if possible), and request that the error be fixed.

Reviewing Reports

With the increased importance of our credit profiles, it is necessary to review these reports periodically to ensure accuracy. As mentioned, the FACT Act allows you to receive copies of your credit reports for free at least once during each 12-month period. Cambridge highly recommends that you take advantage of this provision, as it has been reported that close to 85% of all credit reports in America contain errors.

To receive a copy of each of your reports, go to www.annualcreditreport.com and complete the required information. You'll be asked a number of questions to verify your identity, including information about accounts you may have had in the past, so it might be a good idea to gather up some old creditor statements before you go online. After you've satisfied the website that it's really you requesting your reports, you'll be granted access to them for as much as a month. You might want to print all three immediately, however, to have working copies you can mark up as you review each entry. If you haven't seen your reports in more than a year, be sure that you order each of your three reports, since the information on file can vary from one reporting agency to another. Generally, subscribers report information to only one or two of the agencies, but rarely to all three. This causes the information in your reports to vary greatly. If you don't have access to the Internet, you can also request your reports by phone by calling the Annual Credit Report Request Service at 1-877-322-8228. You'll still need to complete a verification process to receive your reports, so please allow a few minutes.

If ordering a copy of your reports via telephone, you'll need to provide the following information:

- Name
- Current mailing address
- Social Security Number
- Date of birth

Once you have ordered your reports, it should take approximately 10 to 15 days to receive them in the mail. You can also print out an order form from annualcreditreport.com and order your reports through the mail. It may only take 15 days to receive your reports this way, but, if there are problems verifying your identity, the process can drag on much longer. That's why we recommend using the Internet or your phone.

Performing a Credit Check-up

When you receive your reports, you should examine them in their entirety, not just those items you suspect may be in error. Study each entry carefully to ensure its accuracy. For example, does the item indicate the correct account status? Is the date, amount, and account number correct? In addition, you want to be on the lookout for accounts that may not belong to you. You should also look closely for unauthorized inquiries, incorrect mailing addresses and Social Security numbers, as these may indicate that you have been a victim of identity theft.

Disputing Inaccurate and Incomplete Information

If you find errors or discover that you're a victim of identity theft, there are steps you can take. According to the Fair Credit Reporting Act (FCRA), both the credit reporting agency and the information provider (the person, creditor or organization that provided information about you to the credit reporting agency) are responsible for correcting inaccurate or incomplete information in your report.

When disputing errors in your credit report, you should follow the instructions indicated on the dispute form that accompanies your report. You may also write directly to the credit reporting agency regarding the entries you feel are being reported inaccurately. Try not to dispute more than four to six items in a single letter. If you need to dispute more than four items, mail a separate letter thirty days later (after the first letter was sent), listing the additional items.

Your dispute should be in writing and contain: (1) your complete name and address; (2) a clear identification of each item in dispute; (3) an explanation as to why you dispute the information, and (4) a request that an investigation be initiated. *Be sure to include copies (NOT originals) of documents that support your claim.* You may wish to enclose a copy of your report with the items in question notated. Send your letter by certified mail, return receipt requested, so you have proof that your claim was received. Also, keep copies of your dispute letter and enclosures for your records.

By law, the credit reporting agency must investigate each item, usually within 30 days. During their investigation the agency must communicate with the information provider (the merchant, lender, utility, municipality, etc.) regarding the item in question to determine whether or not the dispute is valid. The information provider must conduct a review of the claim and report its findings to the appropriate credit reporting agency, and to other credit bureaus to which it provides information. If the information provider finds that the disputed information is inaccurate, it must then notify all three credit-reporting agencies so your report can be updated.

If the investigation does not resolve the dispute, you have the right to add a 100-word statement to your file, which will be included in your reports for the next two years. At the conclusion of the investigation, the agency must provide you with a written account of the outcome. If the investigation results in any change, the agencies are also required to provide you with an updated copy of your report. You should receive the updated version within 45-60 days from the date you mailed your dispute letter.

Additional Dispute Measures

The Fair and Accurate Credit Transactions Act (FACTA) of 2003 significantly updates the Fair Credit Reporting Act with additional dispute provisions. One such provision allows consumers, in certain circumstances, to dispute inaccurate information *directly with the subscriber.* Upon receiving notice of the consumer's dispute, the subscriber must review the claim and suspend any negative reporting while their investigation is pending.

Should the dispute arise from a credit report that was provided for free by a credit reporting agency, the agency would have 45 days to conduct an investigation of the item(s) in question. All other disputes must be completed within 30 days as originally outlined in the FCRA.

Missing Accounts

Your credit file may not contain all of your credit accounts. Most national department stores and major credit card accounts are included in your file, but not all. Some creditors, including gasoline card companies, local banks, credit unions, travel and entertainment merchants, may not report to the credit reporting agencies. They are not obligated to do so, and this can be a source of confusion and frustration for many consumers.

If you have these types of accounts, and they are in good standing, you may request that the credit reporting agencies add this information to your profile. Although they are not required to do so, many agencies will add verifiable accounts, for a fee. However, if these creditors do not generally report your activity, the added items will not be updated in your file in the future. You'll have to pay each time to have additional positive information of this type added to your report. If you're trying to build your creditworthiness, this may be worth the cost.

Targeting Accounts that Harm Your Profile

Once you've conducted a thorough review of your credit reports and have taken any appropriate actions necessary, you can begin to focus on the accounts that are causing the most harm to your profile. You will want to focus on the accounts that are behind, most notably those that occurred within the last 12 months or so, since recent payment history carries more weight than what happened several years ago. You can use several of the strategies noted in this guide when working with creditors regarding these accounts. Once you address these accounts, you can move on to older accounts. Furthermore, making on-time payments is a great start toward improving your profile. The longer you pay your bills on time, the better your profile will be, in most cases.

At the same time, you should make arrangements to pay off any accounts that may be in collections. Be aware that paying off a collection account will not immediately remove it from your credit report - it could take years for such a notation to disappear entirely - however, *unpaid* collection accounts are far worse than those you have managed to pay off. Therefore, paying off these accounts will generally place them in better standing. While the accounts will remain on your report for several years, they will at least indicate that your obligations have been satisfied.

Not Knowing Is Not the Best Policy

Many consumers resist viewing their credit reports for fear of what they might contain. There is simply too much riding on your credit to turn a blind eye to them. It's important to realize that, if your credit is poor, it won't *necessarily* remain that way forever. Your current credit profile is simply a snapshot of a particular point in time. The sooner you adopt healthy credit practices, the sooner your credit will begin to improve.

You may take some comfort in the fact that information can only be reported for a certain amount of time. Negative credit notations generally appear on your reports for seven years, and then they must be removed. (This doesn't mean that, once the debt has dropped off your report that you don't owe it anymore. Your credit report has no bearing on the statute of limitations in your state, which determines which debts you still owe.) Bankruptcy notations are treated differently. They stay on your report for ten years. In the meantime, it's *your* responsibility to make sure that every new addition to your report shows evidence of better payment patterns.

You may already know that the information in your credit report is used in determining your credit score. Credit reports and scores are very time-sensitive items. Your score from three months ago is probably not the same score a lender would get from the credit reporting agencies today. If you do have negative notations on your report, even before the seven years have passed, *if* you've re-dedicated yourself to meeting your obligations on time, your credit score should begin to reflect these efforts. If you can be patient and make the necessary adjustments, it is possible to improve your credit score and your overall credit profile. The bottom line is, it's up to you to improve your credit performance from this day forward.

Managing Credit Responsibly

You may find the following strategies helpful when attempting to improve your credit profile.

- Keep your account balances as low as possible on your credit card accounts.
  - High outstanding debt can have a negative effect on your score.
- Pay off debt rather than move it around.
  - The best way to improve your score in this area is by paying down your revolving credit accounts. In fact, owing the same amount but having fewer open accounts may actually result in a lower score.
- Don't close unused or old credit cards as a short-term strategy to raise your score.

    - Shutting down credit accounts lowers the total amount of credit available to you, and it also gives additional weight to any balances you do have when it comes to calculating your credit score.
    - Closing your oldest accounts can actually shorten the length of your reported credit history and make you seem less creditworthy.
- Don’t open a number of new credit cards that you don’t need.
    - This approach could backfire and actually lower your score.
- Don’t open a series of new accounts in a short period of time.
    - If you’ve only been managing credit for a little while, don’t open a lot of new accounts too rapidly.
    - New accounts will lower your average account age, which will have a negative effect on your score, especially if you don’t have a lot of other credit information.
- Re-establish your credit history if you have had problems in the past.
    - Opening new accounts responsibly and paying them off on time will help raise your score in the long term.
- Add positive information whenever possible to show stability in your credit profile.
    - If you have extremely poor credit or have even filed for bankruptcy, don't let your credit status go dormant.
    - The faster you begin to re-establish positive credit, the faster you'll improve your credit profile. One way to achieve this is to get a secured credit card.
- It’s okay to have credit cards, but you must manage them responsibly!

- In general, having credit cards and installment loans (and making timely payments) will raise your score.
- Someone with no credit cards, for example, tends to be a higher risk than someone who has managed credit cards responsibly.

Improving your credit profile takes time. Unfortunately, negative items tend to affect your credit score much more quickly than positive items. Late payments can negatively affect your score in just a few months, whereas paying bills on time may take 6 to 12 months to generate a significant improvement in your score. The best course of action is to adopt healthy credit habits and maintain them.

Identity Theft

Identity theft occurs when someone steals another individual’s personal information to obtain credit, secure loans or mortgages, establish utility accounts, and so on. Identity theft has become increasingly common over the past several years, costing both the lending community and consumers billions of dollars.

How ID Thieves Get Your Information

ID thieves utilize a variety of methods to gain access to your data. Obviously, they may steal your wallet or purse, which most likely contains a lot of information about you. Identity thieves may steal records or information from your place of employment, or they may steal your mail, including bank and credit card statements, credit card offers, new checks, and tax information. Another less glamorous technique is to rummage through your trash, the trash of businesses, or public trash dumps - a practice known as "dumpster diving." If thieves are computer savvy, they may “hack” into your information on public or private databases. They may even steal your credit or debit card numbers at an ATM by capturing the information in a data storage device, a practice known as "skimming."

In some instances, thieves can simply purchase your information. Pretexting is the practice of getting your personal information under false pretenses, which is against the law. Pretexters use a variety of tactics to get your personal information. For example, a pretexter may call, claim they are from a survey firm, and ask you a few questions. When the pretexter has the information they want, they can use it to secure your Social Security number, bank and credit card account numbers, information in your credit report, and the existence and size of your savings and investment portfolios. This information will then be sold to ID thieves.

How Your Information May Be Misused

Once identity thieves have your personal information, they use it in a variety of ways such as:

- Changing the billing address on your credit card accounts.
    - The imposter then runs up charges on your account.
    - Because your bills are being sent to a different address, it may be some time before you realize there's a problem.
- Opening new credit accounts in your name.
    - When they use the credit cards and don't pay the bills, the delinquent accounts are reported on your credit report.
- Establishing utility accounts in your name.
- Opening a bank account in your name and writing bad checks on that account.
- Obtaining identification such as a driver's license, issued with their picture, in your name.
- Applying for a job or filing fraudulent tax returns in your name.
- Giving your name to the police during an arrest.
    - If they don't show up for their court date, a warrant for arrest is issued in your name.

Signs That You May Be a Victim

If an identity thief is opening credit accounts in your name, these accounts are likely to show up on your credit report. *To find out, order copies of each of your credit reports.*

Stay alert for other signs of identity theft, like:

- Failing to receive bills or other mail. Follow up with your creditors if your bills don't arrive on time.
- Receiving credit cards that you didn't apply for.
- Being denied credit, or being offered less favorable credit terms, like a high interest rate, for no apparent reason.
- Receiving calls or letters from debt collectors or businesses about merchandise or services you didn't buy.

To Prevent Identity Theft

While you can't entirely control whether you'll become a victim of this type of fraud, there are steps you can take to minimize your risk. First and foremost, it is extremely important to review your credit report once a year for accuracy (see the Credit Reporting section of this guide for more information). Once you get your reports, review them carefully. Look for inquiries from companies you haven't contacted, accounts you didn't open, and debts that you're not familiar with. You should also ensure that the personal information appearing on the reports is accurate.

- Guard your Social Security number.

    - It is the key to your credit report and banking accounts and is the prime target of criminals.
    - Do not print your Social Security number on your checks.
- Monitor and safeguard the information on your credit report.
    - It contains your Social Security Number, present and prior employers, and a listing of all account numbers - including those that have been closed.
- Shred your receipts, credit card offers, bank statements, returned checks, and other forms of sensitive information before throwing them away.
- Remove your name from the marketing lists of the three credit reporting bureaus to reduce the number of pre-approved credit offers you receive.
- Place the contents of your wallet on a photocopy machine.
    - Copy both sides of your license and credit cards so you have all the account numbers, expiration dates and phone numbers if your wallet or purse is stolen.
- Do not carry extra credit cards, your Social Security card, birth certificate or passport with you unless absolutely necessary.
- When you order new checks, do not have them sent to your home. Pick them up at the bank.
    - If stolen, your checks can be altered and cashed by identity thieves.
- Never give out personal information over the phone. Identity thieves may call, posing as banks or government agencies.
- Check with your employer, landlord, and others with access to your personal data to be sure that they are keeping your records safe.

- Follow your billing cycles closely.
    - A missing credit card bill could mean an identity thief has changed your billing address to his own.
- When creating passwords & PINs, use a random mix of letters and numbers.
    - Do not use information that may be easily discovered by identity thieves.

If You Are a Victim of Identity Theft

The Fair and Accurate Credit Transactions Act (FACTA) of 2003 significantly updates the Fair Credit Reporting Act (FCRA), which was originally passed in 1970. Under the new Act you now have the right to request that a fraud alert be placed on your credit report for 90 days if you suspect you're a victim of identity theft. An extended fraud alert may be placed for a period of seven years, if you provide an "identity theft report," which could include a Federal Trade Commission ID theft affidavit if one were filed with a law enforcement agency. If you go as far as filing a report with the authorities, you can also request copies of relevant records from any creditor, listing the fraudulent charges made by the ID thief. The creditor may take up to 30 days to provide the information.

Users of reports and scores are required by law to honor fraud alerts. They cannot issue a new credit line, an extension of credit or credit card, nor can they respond to a request for an increased credit limit on an existing account, unless reasonable verification steps been taken. Also, if you contact a national credit reporting agency to request a fraud alert, the agency must inform other agencies regarding the suspected fraud. All consumers who place an alert are eligible to receive a free credit report. Persons who place an extended fraud alert may receive two free reports in the first year.

Your first step should be to contact the bank, creditor or lender associated with the account that has been used fraudulently. Work with these institutions to lock the account and investigate the damages.

Contact the credit reporting bureaus

- Equifax: to report fraud, call: 800-525-6285 or write: P.O. Box 740241, Atlanta, GA 30374-0241
- Experian: to report fraud, call: 888-EXPERIAN (397-3742) or write: P.O. Box 9532, Allen TX 75013
- TransUnion: to report fraud, call: 800-680-7289 or write: Fraud Victim Assistance Division, P.O. Box 6790, Fullerton, CA 92834
- You can also call the FTC's Identity Theft Hotline toll-free at 1-877-IDTHEFT (438-4338).

If your identity theft case is serious, you may want to file a police report to document the identity theft. You may need a copy of the report to submit to the credit reporting agencies or financial institutions as proof of the crime.

Credit Scores

Lenders routinely analyze a variety of information, including credit reports, to help them decide whether or not their applicants are good lending candidates - essentially how likely they are to repay a loan and whether the lender could expect payments on time. To aid in their review of credit, many institutions view what is called a credit score. The most popular and trusted score is called the Fair Isaac or FICO Score.

The FICO Scoring System

The credit scoring formula developed by the Fair Isaac Corporation allows the information within your credit report to be distilled into a three-digit number ranging between 300 and 850. The higher the score, the more creditworthy you're considered. The credit reporting agencies now use their own proprietary formulas, based on the FICO model, to generate their own scores. Each agency has its own name for the score that is produced by their organization.

- Equifax produces the "Beacon Score."
- Experian's score is called the "Experian/Fair Isaac Risk Model Score."
- TransUnion uses the Fair Isaac model to produce its own "Empirica Score."

If the information were identical at all three credit reporting agencies, scores from all three would be within a few points of each other. As we've already discussed, however, the way lenders and other businesses report information to the credit reporting agencies sometimes results in different information on each of the reports. To further complicate matters, the reporting agencies may also report the same information in different ways, resulting in slight fluctuations in each of the scores.

The Elements of Your FICO Score

According to Fair Isaac, the breakdown of your FICO score is as follows:

- 35% of the score is determined by payment histories on your credit accounts, with recent history weighted a bit more heavily than the more distant past;
- 30% is based upon the amount of debt you have outstanding with all creditors;
- 15% is produced on the basis of how long you've been a credit user;
- 10% is comprised of very recent history;
- 10% is calculated from the mix of credit you hold, including installment loans (like car loans), leases, mortgages, credit cards, etc.

What is a "Good" or "Bad" FICO Score?

While each creditor uses its own criteria to assess credit risk, the following list illustrates the *general* ranges of credit scores and the grades assigned to each.

- 720 and above: A+ Credit
- 700 – 719: A Credit
- 675 – 699: A- Credit
- 620 – 674: B Credit
- 560 – 619: C Credit

- 500 – 559: C- Credit
- 499 and below: D Credit

<u>Raising Your Credit Score</u>

It's important to realize that if a credit score is low, it won't necessarily stay like that forever. As we've mentioned earlier, when someone reviews your credit, they are simply glimpsing a moment in time. Your credit score is a "snapshot" of your credit history. It changes as new information is added to your credit history, and it can improve if you manage your credit responsibly.

We know that credit scores are made up of five parts. Let's see what you can do within each of these parts to improve your overall score.

PAYMENT HISTORY

- Pay your bills on time. Delinquent payments and collections can have a significant negative impact on your score.
- If you have missed payments, get current and stay current. The longer you pay your bills on time, the better your score.
- Be aware that paying off a collection account will not remove it from your credit report. It will stay on your report for seven years.

AMOUNTS OWED

- Keep balances low on credit cards. Using a high percentage of your available credit will negatively affect your score.

- Pay off debt rather than move it around. The best way to improve your score in this area is by paying down your revolving credit. In fact, owing the same amount but having fewer open accounts may lower your score.
- Don't close unused credit cards as a short-term strategy to raise your score.
- Don't open a number of new credit cards that you don't need. This approach could backfire and actually lower your score.

LENGTH OF CREDIT HISTORY

- If you have only been managing credit for a short time, don't open a lot of new accounts too rapidly. New accounts will lower your average account age, which will have a greater effect on your score than if you don't have a lot of other credit information.

NEW CREDIT

- Re-establish your credit history if you have had problems in the past. Opening new accounts responsibly and paying them off on time will raise your score in the long term.

TYPES OF CREDIT USED

- Apply for and open new credit accounts only as needed.
- It's okay to have credit cards, but you must manage them responsibly! In general, having credit cards and installment loans (and making timely payments) will raise your score. Someone with no credit cards, for example, tends to be a higher risk than someone who has managed credit cards responsibly.

FICO '08

Most of the changes within FICO '08 are designed to more accurately depict the current credit climate. As a result, the new scoring model forgives *occasional* slip-ups; however, repeat offenders will be more adversely affected. For instance, accounts forwarded to collections that total less than $100 will matter less in the calculation of scores. Obviously, you want to avoid having any of your accounts sent to a collection agency; however, with the current state of the economy, this provision is a step in the right direction.

The FICO model has been redesigned to take a more comprehensive overview of your profile. For example, if you have just one account that goes to collections, it should count less if everything else looks good. The new formula also favors a mix of healthy accounts, such as credit cards, car loans, personal and student loans, so maintaining a diverse credit portfolio should help an individual increase his or her score.

There are, however, two changes that will *bring down* an individual's score. Both stem from an industry-wide effort to control risk, which, in this case, has to do with the amount of credit you're *not* using. These days, more lenders are closing cards that aren't being used. Keeping a card open represents a cost to the lender, since they still send out statements every month, but it also represents *risk*, since the cardholder could suddenly start borrowing against their limit as times get tight. Closing the card will negatively impact your score, so you may want to contact your lender to discuss their policy.

The other change under FICO 08 is more troubling. A credit card company can also manage risk by lowering the credit limits of its clients. Let's say you had a credit limit of $5,000 dollars and a balance of $1,000 – you're using 20% of your available credit. But if your lender reduces your credit limit to $2,500, *without making another charge*, you'd suddenly be using 40% of your available credit, and your credit score would come down. It's recommended that you use no more than 25% of your credit limit at any time, which could help you avoid being perceived as a risky client by your lenders. If your lender reduces your credit limit, you can call them to ask for an explanation and contest their decision.

Free Credit Scores

How many of us know our credit score? Sure, we hear a lot about its importance, but very few of us regularly check this all-important number. Due to provisions within the Dodd-Frank Wall Street Reform and Consumer Protection Act, when a credit score is used to establish, or modify your credit terms on credit cards, auto loans and student loans, lenders will be required to share the score used to evaluate your financing request in situations where you are negatively affected. Essentially, those of us who are denied credit, or adversely approved, will receive a notice from the lender detailing the score used in their decision. Furthermore, if your score is used to reevaluate your current credit accounts and the review results in an unfavorable adjustment (that is, a higher interest rate or decreased credit limit), you would receive a similar notice.

What's really helpful is the additional information lenders will be required to disclose when a credit review results in the provision of a credit score. According to the legislation, lenders will also be required to furnish the range of possible scores under the model used to generate the score, the date the score was obtained, and the name of the consumer reporting agency. Now, the really good part is that lenders will also provide up to four key factors that hurt the credit score or up to five factors if the number of inquiries made into the consumer's credit report is a key factor. These factors are helpful as they detail areas of concern within your profile. Knowing where to focus your efforts allows you to formulate a plan to get your credit back into shape.

As mentioned earlier, your credit score is an important factor in understanding your creditworthiness; however, a thorough review of your credit reports are key to understanding your overall profile. Although the new law provides free access to the score associated with an adverse action, you still have two other scores that are not reviewed. You'll recall that there are three credit reporting agencies, so the score provided to you is only one piece of the puzzle. You may purchase your other credit scores; however, taking a look at your credit reports may actually be more helpful. Your score distills the information contained into these reports into a three digit number - generally between 300 and 850, the higher the better. So, your score simply provides a snapshot of your standing. The information you really need to focus on is contained in your reports, and thankfully you can receive copies of your credit reports for free by visiting www.annualcreditreport.com.

Credit Cards

To people who can control their spending, credit and charge cards are nothing more than innocent pieces of plastic. But to those consumers who have difficulty managing their finances, the improper use of credit can have a devastating impact on their lives. Some of the most sensational or unusual of these life stories make it into the mainstream media every week, and their cumulative effect may cause you to avoid using credit cards altogether. It's vital to remember, however, that establishing a positive credit history is integral to your future financial success.

While homeownership and retirement may seem far off, the financial decisions you're making today are shaping the way you'll achieve both. This is because the way you use credit every day determines the interest rates you'll be charged for the privilege of borrowing money in the future. That's why it's important to learn how to use credit wisely. If you're able to manage your finances responsibly, those little pieces of plastic can be used to your advantage.

Types of Cards

Credit Card

By definition, a credit card is considered a loan, so to obtain one you must complete an application to a lender. It's important that you fill out the application honestly and accurately. Don't overstate your income or any other detail in an effort to impress the bank. Such deliberate misstatements can be used against you in a legal action. The lender will evaluate your credit history, income and other factors to decide whether or not they wish to extend credit to you. If you meet their criteria, you'll be required to sign a contract. *It is extremely important that you read and understand the terms of the contract!*

The lender will designate a credit limit for your charges and the interest rate that you'll be assessed. Your credit limit is simply the amount of money you'll have available on a credit card charge. A credit card is considered a revolving account, and your limit will fluctuate based on the balance you carry. For instance, if your credit limit is $3000 and you have an outstanding balance of $500, you'll have $2500 available for charges. Interest is the fee a lender charges for the privilege of borrowing money. If you have good credit, you will earn a lower interest rate; if you have bad credit, you will be charged a higher rate to offset the risk you represent.

Once these terms have been established, the lender will mail your credit card to you. Each month, you'll be sent a statement indicating the purchases made with your card and the total amount owed on the account. You have the option of paying the balance in full, *which is recommended*, or of paying a specified minimum portion of the balance. Credit card issuers usually waive interest charges if the balance is paid in full each month, but typically will charge full interest on the entire outstanding balance from the date of each purchase if the total balance isn't paid.

Debit Cards

Debit cards are offered by banks and are typically linked to your checking account. As you use the card, the monies are debited, or withdrawn, from the account associated with the card. Debit cards typically display either the Visa or MasterCard logo, which allows you to use their payment networks for transactions. You may also purchase pre-paid debit cards from a variety of institutions. This type of debit card is not attached to an account, and the balance loaded on the card functions as your spending limit.

Charge Cards

Charge cards, often also referred to as travel and entertainment cards, are similar to credit cards, but with two important differences. First, there is no credit limit, you can charge to your heart's content. This could present problems as a consequence of the second difference - the balance on a charge card is usually required to be paid in full *each month*. Certain charge cards may allow you to extend repayment, but usually at excessive interest rates.

Not all credit cards are created equal. Each issuer has its own terms and conditions governing the use of their cards. As with any loan product, you should carefully read the conditions of your agreement. If you are unclear about any of the provisions, call the issuer and ask questions. If they can't answer your questions to your satisfaction, move on to another lender that can.

Credit Card Fees

For quite some time, credit cards have been known for the high interest rates they charge. In fact, the average credit card interest rate has been between 15%-19% since 1992. These high interest rates, combined with low minimum payment requirements, have propelled the credit card industry to tremendous growth and profit.

In an effort to offset losses due to federal regulations, the credit card industry has been increasing both the dollar amount and the number of fees that are charged to consumers.

These fees have had a big impact on the bottom line. According to some estimates, 37% of credit card issuer profits are from fees, with 27% derived from late and over-limit fees.

LATE FEES

A late fee is charged any time a payment arrives after its due date. Some consumers are under the impression that if a payment is postmarked before the due date, no late fee will be charged. This is not true. If a credit card payment is just one day late, a late fee can be added to the balance of the account.

OVER-LIMIT FEES

Fees for exceeding the spending limit on your credit card are called over-limit fees. The spending limit on a credit card may be exceeded when the cardholder spends more than allowed, or when finance charges and fees assessed on the account push the balance over its limit. If you occasionally exceed your card's limit, consider placing over-limit protection on the card. This will bar any charge that may cause you to exceed the card's current limit, sparing you the fee.

BALANCE TRANSFER FEES

The credit card industry began making credit cards widely available in the 1990's, giving consumers an opportunity to shop around for the best cards. As the market became more and more competitive, credit card issuers made it easy to transfer a balance from one card to another, hoping to lure competitors' cardholders to their own cards. This created a bit of a problem for issuers. Cardholders began to catch on and started transferring their balances before their low introductory interest rates expired. The result was that credit card issuers did not make a lot of money on their balance transfer offers. The fees charged were typically a percentage of the amount transferred, up to $50.00. These days, the cost of the balance transfer is often much higher, typically 3% of the amount transferred.

ANNUAL FEE

An annual fee is a once-per-year assessment for the "privilege" of using a particular issuer's credit card. Sometimes called a "Membership Fee," annual fees can cost anywhere from $25 to more than $100.

INTEREST RATE PENALTIES

Credit card companies also attach an interest rate penalty for those consumers who pay late or carry a heavy debt load. Sixty-nine percent of the issuers polled by an independent survey group, Consumer Action, state that they will raise interest rates when a customer pays late.

The New World of Credit

The Credit Card Accountability Responsibility and Disclosure Act of 2009 was designed to address arbitrary credit rate increases and excessive fees within the credit card industry. The legislation includes several important consumer protection provisions. The most significant provision of the law limits when credit card issuers can increase interest rates on existing card balances, commonly referred to as retroactive rate increases. There are, however, instances when retroactive rate hikes will still be permissible. These involve consumers who have received an introductory rate that is expiring, when the interest rate is tied to a variable index, or when the cardholder's payment is more than 60 days late.

Even if an individual’s payment is 60 days or more past due, they can expect an interest rate increase, but the new Act doesn’t allow the consumer to be penalized for an inordinate amount of time. Credit card issuers must now restore an individual's original interest rate after a late payment, providing that he or she has made on-time payments during the six-month period following the increase. Should the individual get back on track for six consecutive months, the interest rate must be reduced to the previous level.

Creditors are also required to provide an explanation as to how making only minimum payments will increase the amount of time needed to pay off your debt. Understandably, the economic circumstances in our country have made things difficult for many cardholders, and making minimum payments can be a very tempting option. However, doing so can cost you thousands of additional dollars in interest if making minimum payments becomes a habit. In the same spirit of such disclosures, credit card companies must now provide you with 45 days’ advance notice of significant changes in the terms and conditions of your agreement. Such changes include options related to proposed interest rate increases and any fees that may be assessed. You’ll have the option of rejecting such increases, closing your account, and paying off the balance at your old rate. Unfortunately, given the loss of the open line of credit and the detrimental effect that closing your account might have on your credit score, this is not such a great option, but it’s better than nothing.

Over-limit fees are being overhauled as well. Consumers must be given the option to opt in to over-limit fees. By agreeing to incur over-limit fees, an individual ensures that the transaction will go through when a charge exceeds the card’s credit limit, and that they will be assessed a fee for the convenience. Should an individual opt out of over-limit fees, transactions exceeding the credit limit will be rejected and no fees will be assessed. There are many more changes than I can list here; therefore, I encourage you to conduct some research on the Internet for the complete list of provisions included in the CARD Act of 2009.

Weighing Credit Card Offers

Before taking on any new credit cards, it's important to review your budget to ensure you can comfortably accommodate the obligation. As recommended earlier in this guide, it's best to repay your credit cards in full, but at the very least you should be able to meet the monthly minimum obligation and a healthy amount above and beyond. Therefore, take some time to analyze your spending to see if a new card will adversely impact your financial situation. If you find that you can manage the new obligation, take time to understand the terms offered to you. The Federal Reserve has a great website, Credit Cards, which will help you understand credit card offers so that you can compare apples to apples. The Fed's interactive site helps you weigh considerations such as interest rates, annual fees, rewards and other features.

Next, don't make rash decisions about credit offers. Although you may not have received offers for the past several years, don't let the perks make you overlook the potential cost of credit. Remember, credit card companies are in the business of making money, and nothing is ever free. Twenty-thousand travel miles may seem like a huge bonus, but if you're being charged an extra 5% to get those miles you are indeed paying for it. It's best to compare the offers you're receiving with those being offered online. Bankrate.com and CreditCards.com have wonderful comparison tools that help you determine the best card for your situation. You can search for cards based on a host of criteria, such as low interest rates, balance transfer costs, rewards, cash back, and frequent flyer miles.

Finally, remember that you should always review your credit profile prior to opening any new accounts. An astounding 85% of consumer credit reports contain some type of error, and you'll pay if those mistakes have increased the amount of risk you seem to represent. Credit report errors can not only disqualify you for financing, but also cost you higher interest rates. Therefore, request copies of your reports from annualcreditreport.com and review them carefully for mistakes before you consider any new financial obligations, credit cards or otherwise.

Banking

Banks are depository institutions that provide products to protect and grow your earnings, as well as a system to easily transfer money from one person or business to another. In this sense, banks are critical to the economy because their function is to put their accountholder's money to use by lending it out to others who can use it to buy homes, businesses, etc. As a depositor, you probably run very little risk of losing your money, regardless of the bank's economic function. Due to reserve requirements, or cash the bank must keep on hand, as well as federal insurance protections, banks are among the safest financial institutions.

Banks are also very convenient, since the products and services they offer generally make it easy to manage your finances. As technology has advanced, these institutions have become a one-stop shop for your transactions. Many banks allow your employer to directly deposit your paycheck into your account, provide online bill-paying services to satisfy your obligations, and a host of financial products to meet your financial needs.

Let's review some of the more common products and services offered by banking institutions.

Checking Accounts

A checking account is a valuable tool to use in your day-to-day financial operations, but failing to keep track of your transactions can lead to some big headaches. This type of account allows you to deposit funds and withdraw the available money on demand, typically by writing a check. A check is a document instructing a bank to pay money from a checking account to a specific person or establishment. There are several different types of accounts available to consumers. The following is merely a sample:

BASIC CHECKING ACCOUNTS

This type of account is for people who use a checking account for little more than paying bills and daily expenses, and who do not maintain a high balance. Some basic checking accounts require direct deposit or a low minimum balance to avoid fees.

Because banks have different types of basic accounts, you should get answers to the following questions:

- Do they require direct deposit or a minimum balance?
- Do they charge a monthly fee for services?
- Do they charge a fee for each check you write over a certain limit?

INTEREST-BEARING ACCOUNTS

This type of account pays interest on the money you have in it. It usually requires a minimum balance to open, with an even higher balance to maintain in order to avoid fees. Interest is paid monthly, at the end of your statement cycle. Be aware that the fees for falling below the minimum balance may be more than any interest you might earn.

JOINT CHECKING ACCOUNTS

This account is owned by two or more people, usually sharing a household and expenses. Each co-owner has equal access to the account.

EXPRESS ACCOUNTS

These accounts are designed for people who prefer to bank by ATM, telephone, or personal computer. Because you won't spend much time working with bank employees, express accounts usually offer the following:

- Unlimited check writing
- Low minimum balance requirements
- Low or no monthly fees

When you do visit a bank branch, you can expect to pay a fee to talk to a teller on either a per-visit or monthly basis.

LIFELINE ACCOUNTS

Lifeline checking accounts are designed for low-income bank customers. Lifeline accounts often include the following features:

- Low minimum deposit and balance requirements
- Low monthly fees, ranging from $0 to $3, depending on the bank
- Limits on the number of checks per month that you can write

"NO-FRILLS" CHECKING ACCOUNTS

Many banks offer special checking deals if you are 55 or older, or are a student. The benefits may include:

- Free personal checks
- Free cashier's or travelers checks
- Wider ATM use

- Better rates on loans and credit cards

"FREE CHECKING" ACCOUNTS

"Free Checking" accounts typically require you to maintain a minimum balance in your account, but certain fees, like ATM and per-check fees, are eliminated. This reduced fee structure can be an attractive checking alternative for some people. However, it is important that you maintain the minimum balance or your account will no longer be "free" and you will be charged fees.

"NOW" AND "SUPER NOW" ACCOUNTS

A NOW account (Negotiable Order of Withdrawal) is both a "Free Checking" and an interest-bearing account offered by a savings and loan or "thrift" institution. Typically, the minimum balance on a NOW account exceeds that of a "Free Checking" account and, if your balance falls below the minimum, you could pay a high fee. A Super NOW Account has a higher interest rate and a higher minimum balance than the NOW Account.

Savings Accounts

If you're looking for a product to keep your money safe while it earns a little bit of interest, then a savings account is for you. A savings account is a very important tool for financial wellness. As mentioned throughout this guide, it's important to commit a portion of your earning to savings. Let's face it, life happens. We can't forecast unexpected expenses or emergencies that arise, but we can prepare ourselves for the costs associated with this occurrence by building adequate savings.

The benefit of a savings account is that your money is protected. Yes, you can keep your cash under your mattress, but that's really not the safest spot. It won't earn any interest, and you may yield to temptation with your money so close at hand. With a savings account, you have access to your funds via a debit card or passbook, although the latter account type has diminished over the last few years. Also, many institutions offer on-line access to make banking even more convenient.

BASIC SAVINGS ACCOUNTS

These are deposit accounts that are offered by banks and credit unions. The bank lends your money to people needing loans. In return for using your money, the bank pays you interest, though at a relatively low rate. You do have full access to your money and may withdraw it at any time.

CERTIFICATE OF DEPOSIT (CD)

A CD is a special type of deposit account that pays a higher rate of interest than a regular savings account. The reason you're paid a higher amount is that you agree not to access the money for a specific amount of time, such as 3 months, 6 months, 1 year, and so on. If you do withdraw the money, you will pay a penalty.

MONEY MARKET ACCOUNTS

These accounts act like a combination checking and savings account. The interest on a money market account is generally higher than on a standard savings account. Typically, you must maintain a minimum balance, or pay a fee if you go below it. You can write checks against the funds in this account, but there are limits as to how many.

Credit Unions

An alternative to using a for-profit bank is to become a member of a not-for-profit credit union. There are more than 7000 credit unions in the United States, with just over 90 million members. There are plenty of reasons to consider using a credit union. Typically, you'll receive higher interest rates on savings accounts and certificates of deposits. You may also receive more favorable terms on home and auto loans, and even credit cards. Credit unions have an ATM network larger than America's biggest bank, and some will even rebate any ATM fees you're charged if you go outside their network. To find a credit union near you, visit the Credit Union National Association's Website at www.creditunion.coop.

Collection Accounts

All sorts of things can happen in life, some of which may be unpleasant. One of the more unpleasant experiences you may endure is that of falling delinquent on your bill payments. Whatever caused you to fall behind on your bills may only be made worse when it comes to dealing with a collection agency, as bill collectors have developed a reputation for being unduly aggressive. If you want to survive the experience without adding to your stress level, it's important that you understand the collection process.

Who are you dealing with?

When collection activities begin, it is important to determine if you're corresponding with the original lender or a collection agency, as this will dictate your strategy for dealing with the matter. As you might imagine, dealing with an original creditor can be favorable, since they view the accountholder as an individual who may continue to do business with them once the matter is rectified. Collection agencies, on the other hand, have little interest in a person's financial future. They are simply eager to be paid, sooner rather than later.

Original Creditors

Whenever possible, you should do your best to keep your account with the original creditor and prevent it from going to collections. This means making contact with the creditor when you realize you won't be able to pay your bill. Ask if they'll allow you to make partial payments or whether they have a hardship program. It never hurts to ask. Of course, you'll have to know your budget before you propose even partial payments if your circumstances are strained. Remember, the original creditor probably wants to keep you as a customer, but you have to hold up your end of the bargain if they give you a break. If you can't, or if you fail to contact your creditor in the first place, they'll eventually have no choice but to sell your account to a collection agency.

Collection Agencies

Typically, a lender will attempt to collect an unpaid debt for six months. If their attempts at contacting the accountholder go unanswered, lenders will usually refer the matter to a professional collection agency. While most collection agencies take their cues from the original lender, some are given free rein to collect the debts they've purchased. After the agency has bought your obligation from the original creditor, they can use a variety of means to get you to pay. Many of their methods may stretch the boundaries of what is legal, but the less scrupulous agencies prey on your lack of knowledge about your rights as a consumer.

Your Rights

The Fair Debt Collection Practices Act (FDCPA) protects consumers in the event that their accounts become subject to collections. The federal law differentiates between third-party collectors and lenders attempting to collect their own debt (original creditors). While the FDCPA does not govern the activities of the original creditor, many states have developed their own laws that apply to all collectors.

One of the most important provisions of the FDCPA involves the disclosures that must be presented when collection activities begin. As stipulated in the Act, the first collection letter is required to contain the dollar amount of the debt, the name of the original lender, a notice informing the accountholder of their right to dispute the debt within 30 days of the letter, and their intention to collect should the debt go unchallenged. Cambridge recommends that you request the agency to provide verification of the debt, since errors often occur, and, if the account is old, sufficient documentation of the debt may no longer exist. (Presuming that the debt is valid, you should use the time to review your budget. It *must* be accurate at this point.) While the initial correspondence should provide directions about verifying the debt, you should send a written request to the agency as soon as possible.

The Collections Process Begins

When dealing with collection calls, it is important to keep in mind that a collection call is just that - a phone call. As unpleasant as it may be, you should not let a phone call ruin your day. Collectors already have an understanding of the situation you're facing. They know the stress and nervousness you're experiencing all too well. To push a debtor's buttons, some collectors will come across as aggressive and next to impossible to work with. On the flipside, other collectors will appear to be accommodating and downright pleasant. These collectors are hoping that their rapport will cause you to let your guard down, ultimately offering up too much information about your financial situation.

Let’s review a few of the things bill collectors can and can’t do when communicating with debtors. Collectors are forbidden from harassing or abusing individuals or any third parties they may contact.

Examples of restricted behavior include:

- Threatening violence,
- Use of profanity, or
- Making continuous telephone calls.

The best course of action when subjected to such abuses is to document the conversation, either by recording the call (if that is permitted in your state) or by allowing a friend or relative to listen in and take notes. The collector may insist that this isn’t legal. If it’s your name on the account, you can grant such authority. Should you find yourself in court over the matter, or pursue action against the collector for violations of the FDCPA, each incident of inappropriate behavior can build a strong case against the agency.

While we are on the subject of collection communications, please realize that an agency can contact a debtor in person, by mail, telephone, or fax. However, a debt collector may not contact someone at inconvenient times, typically before 8 a.m. or after 9 p.m. A collector may not contact a debtor’s place of employment if they know their employer does not allow for personal calls. There are also legal limits on a collector’s ability to contact the debtor for the collection of debt. For instance, the collector must contact an individual directly unless the agency has been informed that an attorney is representing the debtor. The collector may also contact a debtor's friends, family and neighbors to verify the individual’s contact information. If a collector contacts these parties, they must state their name and that the nature of the correspondence is to confirm an individual's whereabouts. Collectors are prohibited from stating their employer's name, unless asked, or that a debtor is in the midst of collection activity.

Debtors do have the right to request that collectors cease from contacting them, but that does not erase the debt. Once the collector receives a request to cease communications (via a cease-and-desist letter), they may not contact you again, except to confirm they will cease their efforts or to provide notification of specific actions that may be taken. The debt collector, or original creditor, may still have the right to file a lawsuit against you, and they may do so in this situation, now that you've cut off negotiations.

Collectors are also regulated as to what they may state in their attempts to collect a debt. For instance, debt collectors may not use any false or misleading statements when collecting a debt. Examples of false statements would include:

- Implying that they are attorneys or government representatives when they are not,
- Implying that the debtor has committed a crime,
- Falsely representing that they operate or work for a credit bureau,
- Misrepresenting the amount of the debt owed,
- Indicating that papers being sent are legal forms when they are not, or
- Indicating that papers being sent are not legal forms when they are.
- Suggesting that a debtor will be arrested if they do not pay the debt,
- Indicating that they will seize, garnish, attach, or sell property or wages, unless the collection agency or lender intends to do so and it is legal to do so, or

- Indicating that actions, such as a lawsuit, will be taken against the debtor when such action may not legally be taken or when they do not intend to take such action.

Finally, debt collectors may not engage in unfair practices when they attempt to collect a debt. For example, collectors may not

- Collect any amount greater than the debt, unless state law permits such a charge,
- Deposit a postdated check prematurely,
- Use deception to make the debtor accept collect calls or pay for telegrams, or
- Contact the debtor by postcard.

Violations of the Fair Debt Collection Practices Act

Not all collectors are created equal; some are thoroughly professional, while others will stop at nothing to collect whatever they can from you to secure their commission. Anyone who feels as though their FDCPA rights have been violated has options. As mentioned earlier, it is important to document all instances of unfair treatment. A written log indicating the collector's name, company, time of call, and a summary of the conversation may suffice. In some states consumers can record conversations with collectors; however, it is important to verify if it is legal to do so where you live. A formal complaint should be lodged with the Federal Trade Commission, your state's Attorney General's office, and any other applicable state agency. In addition, you should inform the original creditor about the actions of any aggressive collection agencies.

First Things First

When you're ready to negotiate repayment, your first point of contact should be the original creditor, unless the account has already been sold to a collection agency. As mentioned earlier, there are better chances working with an original lender because of the previous lending relationship – these companies would like to keep their customers. Banks are keenly aware that many financial difficulties are temporary. Therefore, they will attempt to treat debtors in a fairer manner than a collection agency would.

When contacting the original lender, the request should be made to recall the debt so repayment may be worked out directly. One of three things can happen 1) they agree, 2) they refuse, or 3) they do both. The first two options are rather simple. First, the lender could agree and start you out on a repayment plan. But, the lender could reject the proposal for a few reasons. Some lenders do not want to be bothered working as collection agents, or the debt may have been written off and sold to a collection agency. In either situation, you will be left dealing with the collection agent. The third scenario is a bit tricky. The lender may reject the proposal of working with the debtor; however, they will work out a payment plan that the collection agency must honor.

The "Truth"

It has been said that honesty is the best policy, and that philosophy holds true for dealing with collectors. Believe us when we tell you that they have heard it all; therefore, collection agents will treat everything with skepticism. Still, you shouldn't hesitate to explain your situation - why payment cannot be made, when payment can be expected, how much payment a collector will receive, and so on. There are some details that should not be shared, such as the name of your current employer, your income, or even the amount owed. (That is information the collector should already have.)

It is critically important that you avoid making any repayment arrangements that cannot be maintained. Even if your budget indicates that you have absolutely no money available, you should still expect that the collector will still try to elicit payments from you. They will suggest borrowing from family, selling assets, or maybe even paying with another credit card. If you can send money, stick to the plan. If you can only afford $50 a month - that is that. While it is not going to please the bill collector, in time it will satisfy the outstanding obligation.

Another important aspect to consider is the number of collectors you have to deal with. If you're behind on multiple accounts you'll need to divide your available funds among all of the obligations and avoid making promises to the collector who calls the most or screams the loudest. Too often, people try to satisfy one collector, but leave nothing for the others. Remember, each bill collectors is worried about their account, not your overall financial situation. Even though you're only able to give smaller amounts, something is better than nothing.

Beyond Collections

For a variety of reasons, you may be unable to come to an agreement with your bill collectors. If the bill collector feels as though they've exhausted all their options, they may file a lawsuit. This is quite serious, and you might consider hiring legal counsel, particularly if the debt in question is substantial.

Typically, a collector will file a petition with the debtor's local county court stating their claim that collection efforts have been unsuccessful. Once filed, the collection agency's lawyer will have the debtor served with a copy of the petition, as well as a summons. The summons will contain all of the necessary information to comply with the suit. The debtor will be named as the defendant, the collection agency as the plaintiff, the reason for the suit, and the date both parties must appear in court. *Do not ignore the court date!* If you fail to appear, the collection agency will most likely be awarded victory. (We will discuss some of the ramifications of losing such cases later in this chapter.) Once served with a summons, the defendant is required to provide an answer to the complaint. The summons will inform the defendant as to the period of time available to file an answer – typically a month, sometimes shorter. It is important to file an answer within the allotted time. If you fail to do so, the creditor may file for, and receive a default judgment. When submitting an answer, it is helpful to provide your most current spending plan to show the court, and the collector, the feasibility of repayment. This can help you negotiate a settlement, or structure a comfortable repayment plan.

Judgments

A judgment is a finding though the courts that your debt is valid, and allows the collector to employ more aggressive tactics to be paid. Judgments are very serious, and permit collectors to *legally* take a debtor's property, and even their wages. The judgment itself can remain in place indefinitely until the debts are repaid; depending upon the state you live in.

Judgment Enforcement

Typically, a creditor will enforce a judgment in three ways – liens, levees or wage attachments. A lien on property means that before a sale or refinancing can take place, the creditor must first be satisfied. Liens will allow the collector to become a partial titleholder of property - a home, car or other business asset. Certain items may be exempt from this method of collection; however, property exemptions vary by state. Now, the collector who has secured the lien does not have to wait for the debtor to sell the property to collect their funds, they may execute the lien, which means force the sale of the property. In this scenario, local law enforcement will size the property through court order and offer it up for auction. Levees work in a similar fashion to liens – law enforcement will seize property and offer it for auction, if applicable. The distinction is that a levy can be executed against any property that holds value – including bank accounts. Finally, a collector can attempt to secure a wage attachment. In this scenario, the collector would garnish the debtor's wages until the debt is satisfied. The debtor's employer would be directed to deduct a portion of their net wages (after taxes and deductions) from each pay period and send it directly to the collector. Depending upon the state in which you live, the percentage available for garnishment can vary, and be very high – as much as 50% in cases involving support orders and taxes.

Recommendations

The legal process can be complicated, so it's recommended that you conduct an overview of the collection laws in your state. In addition, we strongly recommend that you speak with an attorney to get a better understanding of your rights and liabilities.

Homeownership

For many of us, the American Dream has always meant a home of our own, but the country's recent economic difficulty has caused many people to question homeownership. A decade ago no one could have imagined that properties would decline in value to the extent that they did between 2008 and 2011. Most of what happened over those years was artificial. For example, with the introduction of several exotic mortgage products, a lot of people purchased homes they would never be able to otherwise afford. At the same time, because the prices of homes were growing at an extraordinary rate, people jumped into the housing market looking to make a quick profit, or simply to buy a home before prices got too high. Unfortunately, the housing bubble had to burst, and with it went the dreams of many would-be homeowners. In the immediate aftermath, most areas of the country experienced rapid increases in the number of foreclosures and unprecedented losses in property values. The decision to purchase a home is serious. If you're a typical consumer, it's the largest purchase you'll make in your life, and there are a lot of things you'll need to consider before signing on the bottom line.

First among your considerations should be affordability. This goes beyond making the monthly payment. When you own your home there's no landlord to call if something goes wrong. Maintenance and repairs are solely your responsibility. For example, it costs between $8000 and $20,000 to replace a roof. If you're a new homeowner, you'll have little or no equity to draw upon for financing. What if you're overextended on your credit cards? How would you afford the expense? You would have to rely on savings.

When you start thinking about homeownership, you should also be thinking about becoming a disciplined saver. Things happen, and you have to be prepared. Not only are you going to be faced with maintenance and repair costs, you also have to the plan for the unexpected. As we've seen with our most recent economy, the labor market has changed. Long-term unemployment is at historic levels, and salaries are growing at a weak rate. You can't rely on large raises to help with future costs, nor can you expect to be scooped up if you lose your job. Therefore, you'll also have to plan for a larger emergency fund. (As mentioned in the spending plan section, it's recommended that you have 8 to 10 months' worth of expenses in your emergency fund.) Not only will your fund have to include mortgage payments, you'll have to set aside a regular amount for potential home repairs.

Despite our current economic downturn - as bad as it has been - there is still confidence that most homes that have experienced a decline in value will eventually recover the ground they've lost, and in some markets, that's already happening. It's important to remember, then, that keeping a "long-term" investment perspective when it comes to our home is critical. Buying a home should *not* be thought of as a short-cut to wealth.

There are a number of benefits to homeownership you may not have considered. For example, homeownership increases an individual's self-esteem and confidence. National surveys have indicated that homeowners are generally more satisfied with their lives, and have increased feelings of freedom, security, empowerment and independence. Homeownership creates a positive and stable environment in which to raise a family. The ability to create a nurturing and encouraging atmosphere is an important consideration for all parents, and, for many, that's something they feel they can accomplish more easily in a home of their own.

Homeownership is also important to the vitality of neighborhoods *and* to the nation's economic stability. Owning a home gives you a financial stake in your community – if the neighborhood prospers, your home value will increase – but it goes deeper than that. There is a sense of *pride* in having something to call your own, and that pride often motivates people to work together to create a better living environment for everyone within the community. This results in stronger and safer neighborhoods, since homeowners are more likely to be involved in community organizations and other activities.

Communities also benefit from increased tax revenues and a greater level of investment by businesses. Higher municipal income means better local services, a win-win situation for residents, and more business investment leads to an increase in the variety of goods and services available within the neighborhood, not to mention the enhanced job market.

Finally, homeownership is important for the economy. Our pursuit of the American Dream creates jobs in construction, which has a true trickle-down effect on the financial health of retail entities that serve the community.

It's understandable that many of you might be nervous about purchasing a home - the recent housing market slump has had devastating consequences for many homeowners, but it has also created a number of opportunities. There is a tremendous amount of housing inventory right now, and some fantastic deals you can take advantage of, *if* you're properly prepared. One of the best ways to learn what you need to know about buying a home is by contacting a certified housing counseling agency. A HUD-approved housing counselor can show you the potential benefits of buying a home, helping you recognize any barriers that might exist, *and* show you how to determine how much home you can safely afford. Best of all, your counselor will also educate you on ways to evaluate and understand the overall mortgage lending process, which is often a mystery to many first-time homebuyers.

Working with a certified housing counselor provides potential homebuyers with the tools and resources they need to become homeowners. Many housing counseling agencies offer a variety of programs, covering everything involved in the process of purchasing a home, including methods to strengthen your credit, finding the right mortgage, home inspections, and even foreclosure prevention. In order to provide a complete range of home-buying services, reputable housing counseling agencies work diligently with local banks, mortgage companies, attorneys, real estate firms, and other government agencies, all in an effort to give you the most current information available. Before you enter into one of the biggest purchases of your life, you might want to set aside a few hours of your time to talk to a certified housing counselor, you'll be glad you did. To locate a housing counseling agency in your neighborhood, please check your Yellow Pages, or simply Google "housing counseling" and your ZIP code.

Buying vs. Renting

When it comes to homeownership, we often find ourselves asking, "Is now a good time to buy?" Perhaps the better question would be, "Is now a good time for ***me*** to buy?" Although interest rates are at historic lows and home values have receded to their 'pre-boom' levels, this doesn't mean that homeownership is for everyone. There are many factors that must be weighed, so it's important to maintain a broad view of how being a homeowner will affect your life. So what is it: rent or buy? In order to accurately answer that question we first have to answer some specific questions about our own circumstances.

One of the first questions prospective homeowners should ask themselves is how long they will be in the home. A recent analysis by Barry Ritholtz of www.ritholtz.com examined the short-term costs associated with buying versus renting. His findings may make you rethink your homeownership goals. Using sources such as Kiplinger and the New York Times, Mr. Ritholtz evaluated the costs associated with buying and renting over the first five years of occupancy. The comparison was based on a home valued at $223,000 and a rental unit costing $1,500 a month. In the scenario, the homeowner made a 10% down payment and mortgaged $200,700. The analysis examines the purchase or rental costs, the yearly costs, lost opportunity costs, and selling or leaving your rental costs on a cumulative basis for the first five years.

Initially, renting is far cheaper than homeownership. The purchase costs versus the initial rental costs paint a stark contrast. The down payment and closing costs totaled $31,220, while the rental deposit is just $1,500. The yearly costs are where things get interesting. Homeowners have a host of costs associated with ownership. Included among these are the mortgage payments, principle and interest costs, property taxes, utilities, renovation and maintenance, and homeowners insurance. The price tag after five years - $181,110. Renters over the same period would pay $95,564 in rent, and $1,261 for renters insurance.

The analysis also examines the lost opportunity costs associated with each housing option. If you were to invest a dollar, it would grow over time. A dollar that is paid out loses the opportunity to grow, so the amount it could have grown had it been used to create wealth is a lost opportunity cost. For the homeownership option, the lost opportunity costs are $12,201, while the option of renting represents a loss of $6,880 over five years.

Looking at this example, the option of homeownership is not the best option if you were to remain in the home for less than five years. However, if you were going to remain in the house for five or more years, homeownership would be the better option. The comparison concludes with a six-year total for each option. Considering all the factors discussed, the six-year totals for renting would be $103,706; however, for homeownership the total is nearly as much: $102,060.

The comparison is not perfect. Critics have noted that some items often associated with homeownership were left out of the comparison. For instance, one commenter pointed out that some important homeownership costs were omitted. Among those items was a new roof every 15 to 20 years, new paint every 8 to 12 years, a new furnace, and other expenses in the years beyond those reviewed in the comparison. Also absent were the tax benefits of homeownership, which are a great relief to many homeowners each spring.

The comparison ***is*** useful in planning your short-term needs, however. One of the best ways to help determine whether homeownership is right for you is to sit with a counselor from a HUD-approved housing counseling agency such as Cambridge Credit Counseling. To find an agency near you, please visit HUD.gov.

Renters Insurance

If you're among the 35 million Americans who occupy rental units in the United States, perhaps the most important type of insurance to consider is renters insurance. Although such insurance is not mandatory, it can come in very handy. Renters insurance can help protect your personal belongings against fire, theft and vandalism. This type of insurance can also help protect you in case of a liability lawsuit, which could stem from someone injuring themselves in your apartment or rented house. Many renters mistakenly believe that their landlord's insurance will cover any losses they suffer; however, this is not the case. Landlords typically carry insurance on the property itself; therefore, the contents of your household are unprotected.

Do you need renters insurance? A simple exercise can help you find your answer. First, take a look around your living space and think about what it would cost to replace the items you own. Make a list of all your belongings - furniture, electronics, clothing and anything else of value to you. Now, start assigning prices to each of these items. Granted, it may be difficult to assign costs to everything you own, but it's okay to guess. When you're done assigning prices, add everything up. Do you have enough money available to replace these items if there were a fire? Many of you may not, and even if you have money available, think about the other costs that will be associated with such a disaster. Not only would you have to replace your belongings, you'll need temporary housing and, eventually, a new place to live. Needless to say, an insurance policy that covers all these items could not only save you money, but also give you peace of mind.

There are some things you want to keep in mind when considering rental insurance policies. First, the amount of coverage you need will be a major factor in the price of the policy. Think carefully about the amount of coverage you purchase, since buying too much insurance can be costly. You can go back to our previous exercise to determine the dollar amount you actually need. Another factor you'll have to consider is the deductible you'll be paying. A deductible is the amount of money you must pay before the insurance company's coverage begins. If you choose a higher deductible you can reduce the monthly cost of your policy. You'll also need to decide what type of reimbursement you're seeking. Actual Cash Value reimbursement will provide you with the cash value of your items at the time of loss, while Replacement Cost will provide you reimbursement to receive comparable replacements. For instance, if you have a three-year-old computer estimated at $300 in value at the time of the loss, you would receive $300 if you had an Actual Cash Value policy. However, if you opted for the Replacement Cost option, your insurance company would reimburse you with the funds to buy a comparable computer system. While the Replacement Cost option is a little more expensive, it may actually be the better value.

How much does rental insurance cost? Well, I'm happy to say it costs a lot less than you might think. The average policies cost anywhere between $10 and $25 a month. Even though this is really inexpensive, I recommend you compare prices and shop around. If you already have insurance policies through a company, contact them first to see if they offer multiple policy discounts. Also, be sure to ask about any discounts you may qualify for, such as maintaining working smoke detectors in your home, installing dead-bolt locks, or additional discounts if you're retired. Finally, to save even more on renters insurance, pay your premium in one payment, which will save you on monthly installment fees.

How Much Home Can You Afford?

Homeownership has long been the focus of the American Dream. The housing boom at the turn of the century gave many individuals the opportunity to achieve this dream; unfortunately, a combination of exotic mortgage products and an unprepared public led to one of the largest housing crises in decades. Therefore, in order to avoid a repeat of history, it is very important for consumers to develop an understanding of exactly how much home they can afford. This knowledge will help people secure mortgages that are appropriate for their situation and within their means to maintain.

When determining the amount of mortgage payment you can reasonably sustain, it's advisable to look at it from two perspectives. First, it's important to understand how much of a mortgage you will qualify for. This is dependent on two specific ratios which we will discuss in a few moments. Second, and perhaps more important, you have to determine how much home you really need. Lenders will qualify you according to current underwriting procedures, not necessarily what you can afford. Therefore, the burden falls on you to understand exactly the type of mortgage payment you can sustain. For instance, when determining affordability, lenders typically base their calculations on your gross monthly income. As you know, your gross income represents earnings before taxes and other deductions are taken out. For example, if you were to earn $50,000 a year, your gross income each month would be around $4,100. However, depending upon your tax bracket, your net income would be very different. In this scenario, your tax obligation would be approximately $8,600 annually, which would make your monthly net income $3,376. That's a big difference.

Furthermore, there are other aspects of affordability that are not taken into consideration. Do you pay for childcare? Do you pay child support? If you have any obligations that are not considered debts, yet you have to pay each month, this can dramatically change your ability to maintain a mortgage payment. Therefore, creating a realistic budget is the very first step in understanding what you can afford. When determining affordability, it is highly recommended that you contact a HUD- certified housing counseling agency, such as Cambridge Credit Counseling, to participate in pre-purchase counseling. This process will not only help prepare you for the purchase of a home, your counselor will also discuss other expenses you'll likely incur, some of which may further challenge your ability to maintain your mortgage payment.

So, how do lenders determine how much of a mortgage you can bear? There are two calculations employed by lenders to determine mortgage sustainability. The first calculation is that of *a borrower's housing ratio*. The housing ratio is the percentage of your gross monthly income that can be used to make monthly house payments. This would include principal, interest, taxes and insurance. Our previous example yielded a gross monthly income of $4100, so let's base our calculation on that. In that situation you would take the gross monthly income and multiply it by the recommended 28% of income which should be used for such an expense. Different loan programs may allow for different housing ratios; however, we'll focus on the more traditional approach. So, we take our $4100, multiply it by 28%, and come up with $1,148 - the monthly mortgage payment the lender believes you can sustain.

Lenders also take a second look by adding any other household debt - credit card debt, car loans, college loans, and so on, into their determination. After the debt is added, the optimal debt-to-income ratio for sustainability is 36%. Again, there are different loan programs that can accommodate higher ratios, but we are focusing on broadly accepted practices. Okay, now we take the gross monthly income, $4100, multiply it by 36%, and come up with $1476. This figure represents the maximum recommended amount to be used for combined debt repayment, including your mortgage.

It is important to note that mortgage brokers and lenders use your gross income as a basis of affordability, but there can be a huge disparity between your gross and your net income. Your net income is the amount of money left over after these taxes and deductions have been taken out. For example, if your gross income is $1300, but you then have your medical, dental, taxes, and so on taken out, you'll probably net somewhere around $950. That's a huge difference. Basing a mortgage upon money that never reaches your pocket is simply not practical. A good rule of thumb to go by when deciding how much home you can afford is to take your gross income and multiply it by 2 1/2 to 3 times. For instance, if you were to make $50,000 a year, in theory you should be able to afford a mortgage anywhere between $125,000 and $150,000. Again, this is only a guide to give you a ballpark number. You'll still need to develop a spending plan to determine exactly how much you can afford to pay each month.

In some instances, the lender's calculations may indicate that an individual is "mortgage ready" and on their way to homeownership. Just as easily, however, these numbers can also indicate that you might not be ready to own a home – at least not yet. Although the bank believes you can sustain a payment, we've seen that this is not always the case. Therefore, it is important for you to establish a workable budget, a realistic plan for homeownership, and take some time to speak with a housing counselor to make sure you're on the right path.

How Housing Counselors Help First-Time Homebuyers

A recent homeownership study revealed that individuals shopping for cars spend an average of eight hours researching different makes and models to find one that's just right for their needs. Unfortunately, homeowners were spending an average of just five hours finding a house that's right for them. Considering that a home is probably the biggest expense you will ever take on in your life, it stands to reason that you should commit more time and energy to understanding the homeownership process.

When faced with any questions regarding homeownership, the very first place you should contact is a HUD-approved housing counseling agency. Cambridge Credit Counseling is an agency that helps people throughout Massachusetts and Connecticut with a variety of homeownership needs. If you're outside of these states, you can look in your Yellow Pages to locate a housing counselor close to you. Talking to a housing counselor is probably the most important step that you can take in the homeownership process. Not only will these individuals help you develop a budget, they can also give you valuable advice on how to address credit issues and ultimately help you devise a plan to secure a mortgage that works for your situation.

Avoiding Mortgage Modification Scams

Since the Great Recession began in 2007, nearly 6 million families have faced foreclosure proceedings. In an effort to stem that tide, many independent mortgage servicers and the federal government have developed a variety of loan modification programs. A loan modification may involve a reduction in a homeowner's interest rate, an extension of loan terms, a different type of loan, or any combination of these remedies. Understandably, many people facing foreclosure eagerly seek the relief these programs can provide, especially if it means they can avoid losing their home. Unfortunately, the marketplace is ripe with scam artists poised to take advantage of vulnerable, and often desperate, homeowners. If you're worried about foreclosure, or are interested in modifying the terms of your existing mortgage, there are safe and reliable agencies that can help you understand your options.

Foreclosure prevention counseling is available free of charge through local organizations approved by the U.S. Department of Housing and Urban Development, or "HUD," which has reviewed and approved hundreds of housing counseling agencies across the country. HUD-approved agencies are not permitted to charge consumers for their foreclosure prevention services, but rest assured, this is not a case of "you get what you pay for." The preparation and training to become certified as a Foreclosure Default Counselor is a rigorous process. Those counselors who pass their certification exams aren't sales people – they're obligated to provide you with unbiased assistance and advice. They cannot and will not recommend a particular lender or force you to choose one option over another. They're available to help you *understand* those options. *You* make the decisions.

So, what do you need to be on the lookout for? *Guarantees*, for one thing. A reputable counselor won't guarantee that they can stop the foreclosure process, regardless of your circumstances. Working with a legitimate counselor can certainly increase your chances of keeping your home, but be wary of *anyone* who guarantees results.

One of the more popular scams these days is the *Rent-to-Own* or *Lease-back* scheme, in which homeowners are convinced to sign over ownership of their property, at which point they'll be allowed to remain as a renter at a more comfortable rate. When their finances improve, according to this popular fraud, they'll be able to buy back their home. As you might suspect, the scam artist has no intention of allowing the homeowner to re-purchase the property. Typically, after a few months of lower monthly payments, the new "landlord" raises the rent, knowing that the tenant won't be able to afford the higher payments. After the tenant misses several of the inflated payments, they'll be evicted, and the scam artist will legally own the property.

Some other scammers claim to be affiliates of, or approved by, the U.S. government. To make their ruse seem legitimate, these folks use well-crafted websites and marketing materials containing terms such as "federal," "TARP," or other recognizable phrases and acronyms associated with actual government programs. Typically, these scammers will ask for large up-front fees to help the homeowner avoid foreclosure, relying on the fact that desperate people rarely pause to read the fine print in a service contract. Sadly, of course, these companies provide no real service, leaving desperate homeowners at the mercy of their loan servicer. If you suspect that you're the victim of one of these schemes, you should immediately contact the office of the attorney general in your state.

If you're facing foreclosure, there *are* a few steps you can take to protect yourself from loan modification scams. First, contact your lender or servicer when you fall behind on your payments. You'll want to communicate with their loss mitigation department to identify any specific alternatives to foreclosure that they might offer. Also, be sure to make all of your mortgage payments directly to your lender or servicer. Finally, when considering loan modification alternatives, you *have* to know what you're signing. If you find the agreement too complex, contact a HUD-approved housing counselor or attorney to review the forms with you. Although you don't *need* a third party to work with your lender, the assistance of a HUD-approved counselor can be very helpful. The circumstances surrounding foreclosure are particularly stressful, and having a skilled representative on your side can be comforting. To learn more about mortgage modification programs, go to makinghomeaffordable.gov or call a HUD-approved housing agency. You can find a list of approved housing counseling agencies in each state on HUD's website, www.hud.gov.

Student Loans

For many people, the cost of their student loans exceeds everything but their house payment or rent. Thankfully, there are several loan repayment options available to help make things a little easier. According to the New York Times, the cost of higher education has increased by a staggering 439% since the 1980's, nearly doubling the average student loan debt to $24,000. With the current job market and economic conditions, students with loans may face feelings of anxiety and stress while trying to figure out how to pay off the significant debt they owe.

When starting your post-graduate life, it's important to understand the financial impact of your choices. High levels of debt have already forced many people to default on their loan payments (currently, 7% of loan recipients), and that can spell disaster for one's overall financial profile. In order to avoid defaulting on your loans, it's important to understand the different options for repayment, especially before the payments start. Upon graduating, you'll enter a six-month grace period before your student loan payments are due. Of course, you can make payments during that time frame. Before any payments are made, however, it's important to research the different types of plans offered through your loan provider to determine which will best suit your needs. Two helpful online resources explaining the different plans available are www.direct.ed.gov and www.finaid.org. Let's focus for a moment on the four most popular plans.

Repayment Options

STANDARD REPAYMENT

Under this plan you will pay a fixed monthly amount for a loan term of up to 10 years. Depending on the amount of the loan, the loan term may be shorter than 10 years. There is a $50 minimum monthly payment.

EXTENDED REPAYMENT

This plan is like standard repayment, but allows a loan term of 12 to 30 years, depending on the total amount borrowed. Stretching out the payments over a longer term reduces the size of each payment, but increases the total amount repaid over the lifetime of the loan.

GRADUATED REPAYMENT

Unlike the standard and extended repayment plans, this plan starts off with lower payments, which gradually increase every two years. The loan term is 12 to 30 years, depending on the total amount borrowed. The monthly payment can be no less than 50% and no more than 150% of the monthly payment under the standard repayment plan. The monthly payment must be at least the interest that accrues, and must also be at least $25.

INCOME-BASED REPAYMENT

Income-based repayment allows borrowers with federal student loans to have their monthly payments adjusted to a reasonable amount, based on their family size and income. The student's monthly payments can be capped at 15 percent of their discretionary income. After 25 years of qualifying payments, the remaining debt, including interest, is forgiven.

In October 2011, President Obama announced that the cap will be lowered to 10% for 2012 graduates, and debt will then be forgiven after 20 years.

Loan Consolidation

This is a process that can result in lower monthly payments or better interest rates, but there are a number of factors that need to be considered. One of the advantages of loan consolidation is that it can be done even if you're in default, and it may help you get out.

You may want to consider consolidating if:

- You can't afford the payments on your federal loans, don't qualify for a postponement, and aren't eligible for a low-income plan.
- You qualify for a low-income plan, but are so destitute you can't afford even those low payments.
- You can afford substantial monthly payments, but want to refinance at a lower rate.
- You are already in default, but can afford low monthly payments.
- You don't qualify for loan cancellation.

There are some restrictions.

- Private loans usually can't be consolidated. Check with your servicer.
- Although you can consolidate jointly, both spouses must agree to pay in divorce (You may lose benefits if you consolidate jointly.)

Cancelling Student Loans

If you qualify for loan cancellation, this may be the best option, since the loan is gone and you can be reimbursed for any garnished payments.

The criteria-

- School Closure - The school closed before, during, or immediately after you attended.
- False Certification - If the school didn't certify your credentials before admitting you or admitted you to a program for which you were unqualified for future licensure.
- Your signature was forged on the loan papers.
- Unpaid Refunds - If the school failed to pay you a refund you were owed, you can cancel all or a portion of a loan. Some states also reimburse students in this circumstance.
- Permanent Disability - If you weren't permanently disabled at the time you got the loan, this may be an option. You may request cancellation if your condition is indefinite or will result in your death. Even if you had the condition when you got the loan, if you can prove substantial deterioration you may be able to cancel your loans. Documentation is crucial. As of July 2002, you won't be granted a full discharge immediately, even if you can prove the disability. Instead you'll be granted a "conditional disability discharge," which will suspend payments for 3 years, starting on the day your disability began. At this point they'll check your earnings to see if you made more than 100% of the poverty income for a family of two. If you equaled or exceeded the amount, you won't receive a discharge.
- Participation in a specific volunteer program, teaching program, or military service - You may be able to cancel, or may only be able to suspend your payments temporarily. The list of approved programs and services that may qualify you for cancellation is growing, but fairly long periods of service are generally required before cancellation would be considered.

Postponing Student Loan Payments

These occur in 2 different forms: *deferments* and *forbearances*. Both must be requested from the loan servicer, which will provide details about duration and any other program requirements.

DEFERMENTS

A breather. You still have to pay back the loan, but payments cease for a while. No interest accrues during this period. The most common deferments are granted if you are:

- Enrolled in school at least half-time
- Unemployed but looking for work
- Suffering an economic hardship
- A parent with young children

FORBEARANCE

A postponement or temporary reduction in payments. A forbearance may even be granted while the loan is in default. Please note that *interest continues to accrue during a period of forbearance.*

Considering Bankruptcy

In 2005, the Bankruptcy Abuse Prevention and Consumer Protection Act was enacted to curb perceived abuses of the bankruptcy system. At that time, many people were afraid that the new legislation would limit their ability to seek bankruptcy relief, and 2 million Americans rushed to file before the new law went into effect that fall. Afterward, it looked as though the volume of filings would remain low for a while, but the recent downturn in the economy has filings on the rise once again.

Why do we think this might be the case? Let's look at some statistics for a moment. 600,000 Americans filed for bankruptcy protection in 2006, and in 2008 the number of filings rose to more than *one million*. In the first quarter of 2009, there was a 38% increase in filings compared to a year earlier, leading some bankruptcy experts to believe that as many as 1.6 million Americans could seek bankruptcy relief in 2009. The numbers could surpass 2005's if bankruptcy judges are granted the authority to change the terms of the first mortgage to reflect current market rates.

There are a number of events that commonly lead to bankruptcy, including a reduction in income or job loss, a divorce, or a personal business failure; therefore, it should come as no surprise that filings are growing at such a rapid pace. However, is it the right option for you? Experts agree that bankruptcy should be considered as an absolute last resort, although some would recommend avoiding it altogether. The reality is that bankruptcy exists to help you in difficult financial times. We would simply advise that you consider *all* possible remedies. If you sense that your finances are becoming a problem, your first call should probably be to a non-profit credit counseling service to speak with a certified counselor. Ask for a comprehensive review of your situation to help you determine the best course of action. They might be able to suggest some less painful alternatives.

If you're considering bankruptcy, you should also consult with an attorney who specializes in this practice. The 2005 changes to the bankruptcy code require attorneys representing bankruptcy filers to conduct a thorough investigation of their clients' finances, and they can be held liable for inaccuracies. As you might imagine, this has also caused some attorneys to raise their fees. Don't let this deter you. Bankruptcy can be a complicated process, and having a professional guide working on your behalf is advised.

While bankruptcy is a viable option to alleviate the burdens of debt, it's a measure that should be carefully considered, since it may have a long-lasting effect on your life. Depending upon the chapter you file, the notation will remain on your credit report, and may affect your credit score, for some time. Chapter 7, or liquidation, remains on your credit report for 10 years and Chapter 13, or restructuring, will be reported for 7 years.

Resources

Addiction

Debtors Anonymous
A support group for those recovering from compulsive spending.
781-453-2743
www.debtorsanonymous.org

Alcoholics Anonymous
An international organization dedicated to helping people deal with alcohol addiction.
Look in your Yellow Pages to find a chapter near you.
www.alcoholics-anonymous.org

Narcotics Anonymous
Assists people coping with drug addictions.
818-773-9999 Extension 771.
www.na.org

Gamblers Anonymous
Helps people coping with gambling problems.
Look in your yellow pages to find a chapter near you or call the International Service Office at (213) 386-8789 for more information or a referral.
www.gamblersanonymous.org

Government Agencies & Websites

Medicare
The federal health insurance program for people 65 years of age or older, certain younger people with disabilities, and people with End-Stage Renal Disease (permanent kidney failure with dialysis or a transplant, sometimes called ESRD).
800-633-4227
www.medicare.gov

Medicaid
A joint federal and state program that helps with medical costs for individuals with low incomes and limited resources.
800-633-4227
www.hcfa.gov

U.S. Department of Housing & Urban Development (HUD)
An organization that helps to increase homeownership, support community development, and increase equal access to affordable housing.
www.hud.gov

Social Security Administration
Information regarding Social Security Disability Insurance and Supplemental Security Income.
800-772-1213
www.ssa.gov

Unemployment Benefits
Helps consumers better understand unemployment benefits and eligibility restrictions.
877-US-2JOBS
www.workforcesecurity.doleta.gov

Federal Office of Child Support Enforcement
Access to State Child Support information and agencies through the country.
800-222-4738
www.acf.hhs.gov

Supplemental Nutrition Assistance Program (SNAP)
Access information regarding food assistance programs.
800-221-5689
www.fns.usda.gov/snap

Low Income Energy Assistance Program
State energy assistance applications.
866-674-6327
www.ncat.org/liheap/profiles/energyhelp

Additional Benefits
General website for a variety of government benefits.
800-FED-INFO (800-333-4636)
www.benefits.gov

Student Loans

American Student Assistance
Nonprofit organization that delivers quality delinquency prevention services.
800-343-8883
www.asa.org

Federal Student Loans
Offering a variety of information regarding Student Loans including picking an appropriate school, Student Aid, and repayment options.
800-848-0979
www.ed.gov/students

Credit

Annualcreditreport.com
National Service that provides all consumers with one free credit report per year.
877-322-8228
www.annualcreditreport.com

Trans Union
An agency that maintains credit reports on how consumers manage their credit obligations. You may order a copy of your report for review.
800-888-4213
www.tuc.com

Equifax
An agency that maintains credit reports on how consumers manage their credit obligations. You may order a copy of your report for review.
800-685-1111
www.equifax.com

Experian
An agency that maintains credit reports on how consumers manage their credit obligations. You may order a copy of your report for review.
888-397-3742
www.experian.com

FAIR Isaac
A source for understanding FICO scores. Contains tips on improving your score.
www.myfico.com

Mortgages and Loans
HSH Associates
Publisher of consumer loan information.
www.hsh.com

Fannie Mae
Provides financial products and services that make it possible for low-, moderate-, and middle-income families to buy homes of their own.
www.fanniemae.com

Freddie Mac
An organization that works to stabilize the nation's mortgage markets and expand opportunities for homeownership and affordable rental housing.
www.freddiemac.com

OptOutPrescreen.com
Remove your name from lists for pre-approved offers of credit or insurance.
888-567-8688
www.optoutprescreen.com

Financial Websites & Blogs

Bankrate.com
Provides tools and information to help consumers make informed financial decisions.
www.Bankrate.com

CardWeb.com
An online publisher of information pertaining to all types of credit cards.
www.Cardweb.com

The Dollar Stretcher
Thousands of articles on money-saving concepts.
www.stretcher.com

360 Degrees of Financial Literacy
Free program of the nation's Certified Public Accountants to help Americans understand their personal finances through every stage of life.
www.360financialliteracy.org

MyMoney.gov
Website brought to Americans by 22 Federal entities that work on improving financial literacy and education. Central place for unbiased, reliable information and materials on financial topics of interest.
www.mymoney.gov

Ask Liz Weston
Award-winning, nationally-syndicated personal finance columnist who can make the most complex money topics understandable to the average reader.
www.asklizweston.com

The Simple Dollar
The Simple Dollar is a blog for those of us who need both cents and sense: people fighting debt and bad spending habits while building a financially secure future and still affording a latte or two.
www.thesimpledollar.com

SpendOnLife
Provides up-to-date, accurate information and advice about credit reports and scoring.
www.spendonlife.com

The Consumerist
Empowers consumers by informing and entertaining them about the top consumer issues of the day.
www.consumerist.com

Wise Bread
Community of bloggers helping people live large on a small budget.
www.wisebread.com

Get Rich Slowly
Recently named a best blog of 2011 by *Time* magazine and most inspiring money blog by *Money* magazine — devoted to sensible personal finance.
www.getrichslowly.org

Legal Aid

Law Help.org
State guide of free legal aid programs and answers to questions about legal rights.
www.lawhelp.org

Senior Citizens

AARP
Organization dedicated to helping seniors live more productive lives.
888-687-2277
www.aarp.org

Benefits Checkup
Helps seniors identify benefits that could save money and cover the costs of everyday expenses.
202-479-1200
www.benefitscheckup.org

Grandfamilies

National Association of Child Care Resource & Referral Agencies (NACCRRA)
Works with more than 600 state and local Child Care Resource and Referral agencies to ensure families in every local community have access to quality, affordable child care.
www.naccrra.org

Grandparents Raising Grandchildren
If you take care of grandchildren, find grandparent programs in your state and get information about benefits, assistance, and more.
www.usa.gov/Topics/Grandparents

AARP Foundation GrandCare Support Locator
Connects grandparents with national, state and local groups, programs, resources and services that support grandparents or other relative caregivers as well as grandparents facing visitation issues.
www.giclocalsupport.org

Grandparents as Parents
Providing programs and services for grandparents and other relatives raising at-risk children.
www.grandparentsasparents.org

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