Building Wealth

A BEGINNER'S GUIDE TO SECURING YOUR FINANCIAL FUTURE

FEDERAL RESERVE BANK OF DALLAS

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Financial education supports not only individual well-being, but also the economic health of our nation.

Ben S. Bernanke, Chairman,
Federal Reserve System

Building Wealth: A Beginner's Guide to Securing Your Financial Future offers introductory guidance to individuals and families seeking help to develop a plan for building personal wealth. While a comprehensive discussion of accounting, finance and investment options is beyond the scope of this workbook, it presents an overview of personal wealth-building strategies. For more information and assistance, consult the resource guide at the back. For additional copies of this workbook (also available in Spanish), call (800) 333-4460, ext. 5254, or order online, dallasfedbuildingwealth.org. *Building Wealth* is also available as an animated CD-ROM for PC or Mac and a mobile app, a free download in the app stores for Android, Apple or BlackBerry mobile devices. All *Building Wealth* materials are available at dallasfedbuildingwealth.org.

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Building Wealth

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

DEFINING WEALTH

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

Wealth is…

1. _____

2. _____

3. _____

Examples: Wealth is…

1. *being able to put my kids through college.*

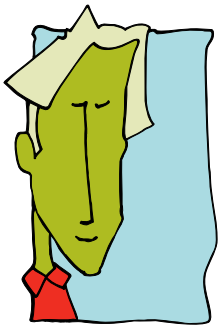
2. *having enough money to buy a house.*

Now that you have defined what wealth means to you, how do you acquire it?

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

① Wealth Creation:
Learn the Language

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



Bob

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

ASSETS – LIABILITIES = NET WORTH

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

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

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

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

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

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

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

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

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

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

Bob discovered his net worth is $24,000. Using Bob's balance sheet as an example, figure your own net worth. Be sure to add any assets and liabilities you have that are not listed here. Remember that net worth is your wealth. Are you worth as much as you want to be?

Bob's Balance Sheet

Wealth-building assets	Amount
Cash	$ 1,500
Savings account	1,000
Stocks, bonds and other investments	5,000
401 (k) retirement plan /IRA	25,000
Market value of home	0
Other assets	
Market value of car	14,000
Total assets	$ 46,500

Liabilities	Amount
Home mortgage	$ 0
Home equity loan	0
Car loan balance	13,000
Credit card balances	3,000
Student loan	5,000
Miscellaneous liabilities	1,500
Total liabilities	$ 22,500
Net worth	$ 24,000

My Balance Sheet

Wealth-building assets	Amount
Cash	
Savings account	
Stocks, bonds and other investments	
401 (k) retirement plan /IRA	
Market value of home	
Other assets	
Market value of car	
Total assets	

Liabilities	Amount
Home mortgage	
Home equity loan	
Car loan balance	
Credit card balances	
Student loan	
Miscellaneous liabilities	
Total liabilities	
Net worth	

② Budget to Save

What would you like your net worth to be

5 years from now? $ _____

10 years from now? $ _____

SET FINANCIAL GOALS

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

Eleanor Roosevelt

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

A personal wealth-creation strategy is based on specific goals. In preparing your goals:

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

In the space provided, list your top goals.

Example: Short-term

1. *In one year, add $500 to my emergency fund.*
2. *In two years, pay off $3,000 in credit card debt.*

Example: Long-term

1. *In 15 years, save $25,000 to help my child with college.*
2. *In 30 years, have $5,000 a month to live on.*

My short-term goals are:

1. _____
2. _____
3. _____

My long-term goals are:

1. _____
2. _____
3. _____

Now you, like Bob, can choose how to meet those goals. This is where budgeting to save comes into play.

DEVELOP A BUDGET AND LIVE BY IT

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

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

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

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

Betty

Betty is a single parent with one child. "I have to budget in order to live on my modest income. I have a little notebook I use to track where every dime goes. Saving is very important to me. When my son was born, I started investing every month in a mutual fund for his college education. I am proud to say that I control my future. I have bought my own home and provided for my son, and I've never bounced a check. You must have common sense regarding money!"

Lynne

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

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

A budget allows you to:

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

To develop a budget, you need to:

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

Track Day-to-Day Spending

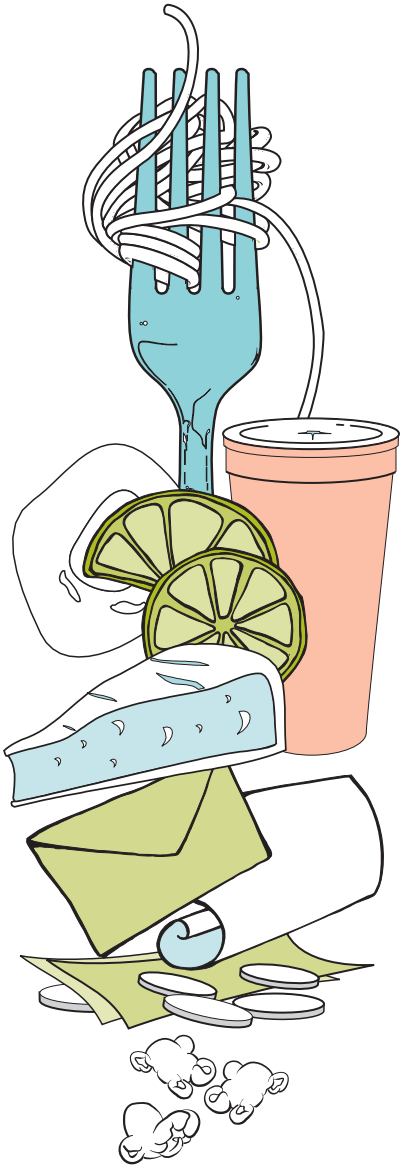
One day, Lynne, the dreamer, realized that to create wealth she had to become more of a doer, like Betty, and plan her financial future. To start, Lynne looked at her finances to see how much money she made and how she was spending it. She set a goal to save $125 a month to put toward her wealth-creation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

She also carried a little notebook in her purse for jotting down her daily spending, whether by cash or debit card, check or credit card. Here is a page from her notebook.

Lynne's Day-to-Day Spending

Date	Expense	Cash/debit/check	Charge
1/2	Breakfast, Get-N-Go	$ 3.56	
1/2	Coffee	1.90	
1/2	Lunch		$ 6.75
1/2	Soft drink	1.25	
1/2	Gas for car		46.00
1/2	Drinks with friends	10.00	
1/2	Groceries		50.00
1/2	Dinner	15.00	
1/2	Newspaper	.50	
1/3	Bacon and eggs, Moonlight Diner	4.95	
1/3	Newspaper	.50	
1/3	Coffee	1.90	
1/3	Lunch with coworkers		5.72
1/3	Dinner		15.00
1/3	Dress		45.00
1/3	Soft drink	1.25	
1/3	Trip to the movies	15.00	
1/4	Breakfast	3.50	
1/4	Coffee	1.90	
1/4	Lunch	5.75	
1/4	Cookies	1.25	
1/4	Newspaper	.50	
1/4	Birthday present	15.00	
1/4	Dinner		6.77
1/5	Breakfast	3.25	
1/5	Coffee	1.90	
1/5	Soft drink	1.25	
1/5	Newspaper	.90	
1/5	Magazine	3.95	
1/6	Breakfast	3.25	
1/6	Coffee	1.90	
1/6	Newspaper	.50	
1/6	Lunch	4.50	
1/6	Cookies	1.25	
1/6	Jacket		50.00
1/6	Movie rental	3.95	

You can study your own spending habits by using this sheet to track daily expenses. Be sure to include items purchased with credit cards, as well as those purchased with cash, debit card or check. Seeing where your money is going now will help you see where you need to make changes to start building wealth.



My Day-to-Day Spending

Date	Expense	Cash/debit/check	Charge

Get a Handle on Income and Expenses

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

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

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

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

Lynne's Monthly Budget

	Current income	Income changes	New budget
Take-home pay	$ 2,235		$ 2,235
Overtime pay		$ 40	$ 40
Pension, Social Security benefits			
Alimony/child support			
Other income			
Total income	$ 2,235	$ 40	$ 2,275

	Current expenses	Spending changes	New budget
Rent	$ 680		$ 680
Renter's insurance	20		20
Electricity	60		60
Gas	30		30
Water	25		25
Telephone	50		50
Cable TV/Internet service	55	–20	35
Insurance (life, disability)	0		0
Charitable donations	0		0
Credit card payment	25		25
Groceries	200		200
Clothing	130	–30	100
Day care/tuition	0		0
Car loan	300		300
Car insurance	75		75
Gas for car	145	–20	125
Meals out & entertainment	425	–50	375
Miscellaneous daily expenses	100	–50	50
Total expenses	$ 2,320	$ –170	$ 2,150
Monthly net (income – expenses)	$ –85		$ 125

Available to save or invest	$ 0		$ 125

Using Lynne's budget as an example, track your income and expenses. Identify changes you can make to increase your income or decrease your expenses, and develop a new budget that includes more savings. Be sure to make reasonable budget changes that you can live with month to month.

To help you maintain the discipline to save:

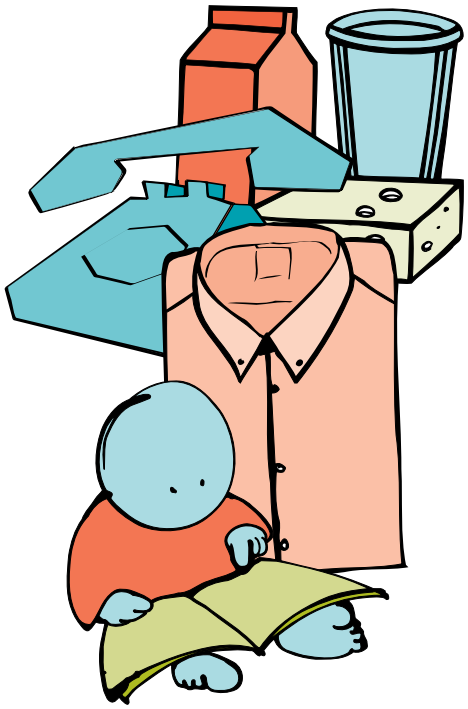
- Save every month.
- Have savings automatically deducted from your paycheck or checking account.
- Base your budget on what's left.

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

How much do you currently save each month? $ _____

How much are you ***going*** to save each month? $ _____

You have now successfully budgeted to save. The next step is saving and investing.



My Monthly Budget

	Current income	Income changes	New budget
Take-home pay			
Overtime pay			
Pension, Social Security benefits			
Alimony/child support			
Other income			
Total income			

	Current expenses	Spending changes	New budget
Rent/House Payment			
Property insurance			
Electricity			
Gas			
Water			
Telephone			
Cable TV/Internet service			
Insurance (life, disability)			
Charitable donations			
Credit card payment			
Groceries			
Clothing			
Day care/tuition			
Car loan			
Car insurance			
Gas for car			
Meals out & entertainment			
Miscellaneous daily expenses			
Total expenses			
Monthly net (income – expenses)			

Available to save or invest			

③ Save and Invest

Take the power of compound interest seriously—and then save.
Dwight R. Lee and Richard B. McKenzie, *Getting Rich in America*

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

GET GUIDANCE

There is an art to choosing ways to invest your savings. Good investments will make money; bad investments will cost money. Do your homework. Gather as much information as you can. Seek advice from licensed or registered advisers. States require licensing or registration for brokers, investment advisers and insurance salespeople, so check with your state securities regulator before trusting any investment adviser. Also, check out the Wealth-Building Resource Guide on page 33 for helpful sites.

TAKE ADVANTAGE OF COMPOUND INTEREST

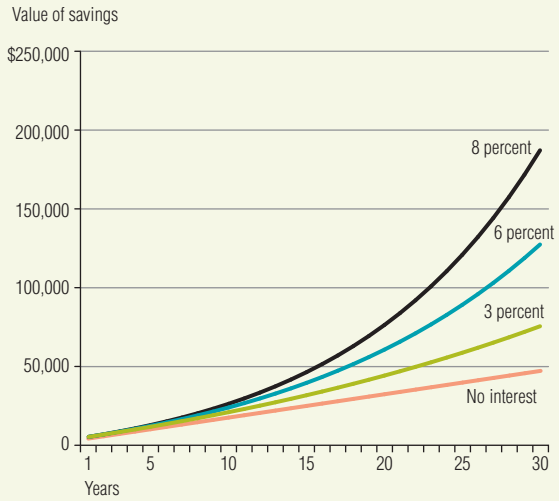
Compound interest helps you build wealth faster. Interest is paid on previously earned interest as well as on the original deposit or investment. For example, $5,000 deposited in a bank at 6 percent interest for a year earns $308 if the interest is compounded monthly. In just 5 years, the $5,000 will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

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

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

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

The Compound Interest Advantage



Examples assume $125 monthly deposits;
the compound interest examples assume monthly compounding.

UNDERSTAND THE RISK–EXPECTED RETURN RELATIONSHIP

An investment in knowledge always pays the best interest.

Benjamin Franklin

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

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

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

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

HOW MUCH RISK DO YOU WANT TO TAKE?

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

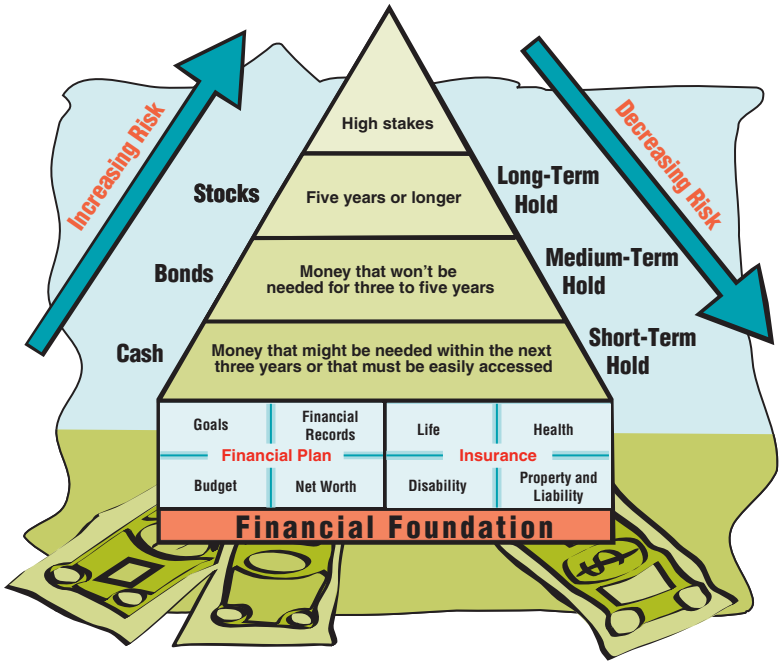
Financial goals. How much money do you want to accumulate over a certain period of time? Your investment decisions should reflect your wealth-creation goals.

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

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

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

Investment Pyramid



NOTE: Information not intended as specific individual investment advice.

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

TOOLS FOR SAVING

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

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

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

Individual Development Accounts

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

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

Find an IDA program near you: cfed.org/programs/idas.

Types of Savings Accounts

Savings account (in general)

- Access your money at any time.
- Earn interest.
- Move money easily from one account to another.
- Savings insured by the FDIC (NCUA for credit unions) up to $250,000.

Money market account

- Earn interest.
- Pay no fees if you maintain a minimum balance.
- May offer check-writing services.
- Savings insured by the FDIC/NCUA up to $250,000.

Certificate of deposit (CD)

- Earn interest during the term (three months, six months, etc.).
- Must leave the deposit in the account for the entire term to avoid an early-withdrawal penalty.
- Receive the principal and interest at the end of the term.
- Savings insured by the FDIC/NCUA up to $250,000.

TOOLS FOR INVESTING

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

Bonds—Lending Your Money

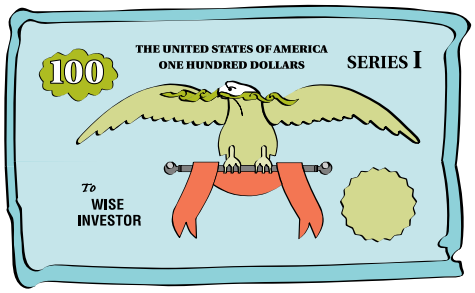
Bonds. When you buy bonds, you are lending money to a federal or state agency, municipality or other issuer, such as a corporation. A bond is like an IOU. The issuer promises to pay a stated rate of interest during the life of the bond and repay the entire face value when the bond comes due or reaches maturity. The interest a bond pays is based primarily on the

A Good Rule of Thumb

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

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

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



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

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

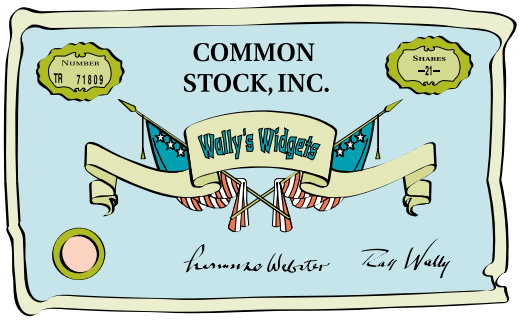
Savings bonds. ***U.S. savings bonds*** are government-issued and government-backed. Unlike other investments, you can't get back less than you put in. There are different types of savings bonds, each with slightly different features and advantages. ***Series I*** bonds are indexed for inflation. The earnings rate on this type of bond combines a fixed rate of return with the annualized rate of inflation. Savings bonds can be purchased in denominations ranging from $50 to $10,000.

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

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

Bonds, bills and notes are sold in increments of $1,000. These securities, along with U.S. savings bonds, can be purchased directly from the Treasury through TreasuryDirect at www.treasurydirect.gov.

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



Stocks—Owning Part of a Company

When you buy ***stock***, you become a part owner of the company and are known as a ***stockholder***, or ***shareholder***. Stockholders can make money in two ways—receiving dividend payments and selling stock that has appreciated. A ***dividend*** is an income distribution by a corporation to its shareholders, usually made quarterly. ***Stock appreciation*** is an increase in the value of stock in the company, generally based on its ability to make money and pay a dividend. However, if the company doesn't perform as expected, the stock's value may go down.

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

Mutual Funds—Investing in Many Companies

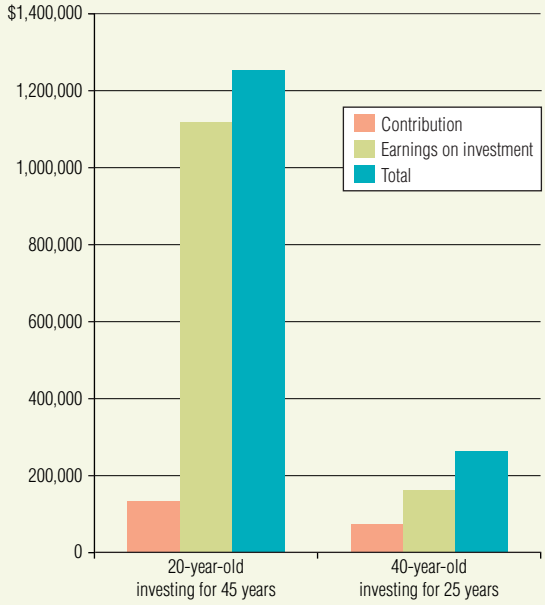
Mutual funds are established to invest many people's money in many firms. When you buy mutual fund shares, you become a shareholder of a fund that has invested in many other companies. By diversifying, a mutual fund spreads risk across numerous companies rather than relying on just one to perform well.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

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

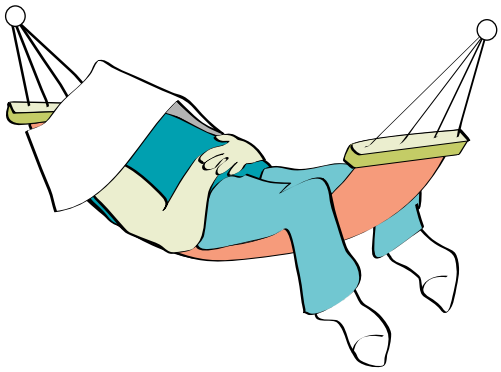
Stocks, bonds and mutual funds can be purchased through a full-service broker if you need investment advice, from a discount broker, or even directly from some companies and mutual funds. Remember, when investing in these products:

- Find good information to help you make informed decisions.
- Make sure you know and understand all the costs associated with buying, selling and managing your investments.
- Beware of investments that seem too good to be true; they probably are.

INVEST FOR RETIREMENT



Assumes an annual investment of $3,000 and an 8 percent rate of return.



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

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

Individual Retirement Accounts

An individual retirement account (IRA) lets you build wealth and retirement security. The money you invest in an IRA grows tax-free until you retire and are ready to withdraw it. You can open an IRA at a bank, brokerage firm, mutual fund or insurance company. IRAs are subject to certain income limitations and other requirements you will need to learn more about, but here is an overview of what they offer, with the maximum tax-free annual contributions as of 2013.

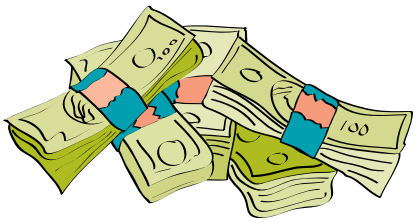
You can contribute up to $5,500 a year to a ***traditional IRA***, as long as you earn $5,500 a year or more. A married couple with only one person working outside the home may contribute a combined total of $11,000 to an IRA and a ***spousal IRA***. Individuals 50 years of age or older may make an additional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

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

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

401(k) Plans

Many companies offer a 401(k) plan for employees' retirement. Participants authorize a certain percentage of their before-tax salary to be deducted from their paycheck and put into a 401(k). Many times, 401(k) funds are professionally managed and employees have a choice of investments that vary in risk. Employees are responsible for learning about the investment choices offered.



By putting a percentage of your salary into a 401(k), you reduce the amount of pay subject to federal and state income tax. Tax-deferred contributions and earnings make up the best one-two punch in investing. In addition, your employer may match a portion of every dollar you invest in the 401(k), up to a certain percentage or dollar amount.

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

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

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

Qualified Plans

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

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

Check the IRS website—www.irs.gov—for current information on tax-deferred investments.

OTHER INVESTMENTS

Building Equity Quicker—A Comparison

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

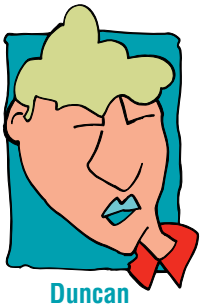
Investing in Your House

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

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

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

Start Your Own Business



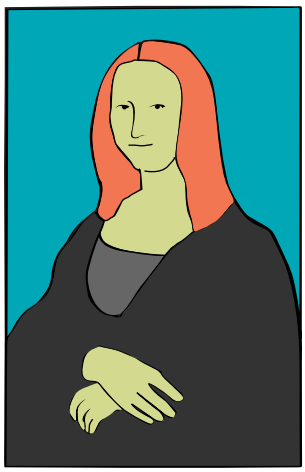
Duncan

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

Duncan had a dream—he wanted to own a business. He worked for a printing company for 10 years and learned every aspect of the business. He and his wife saved every month until they had a sizable nest egg. When they felt the timing was right, they bought a printing press and computer equipment and set up shop in an old warehouse. Duncan's wife kept her job so they would have steady income and benefits while the business got off the ground.

For the next five years, Duncan worked long hours and put all the income back into the business to help it grow. He gave his customers good service, attracted more customers and paid close attention to his expenses. By the sixth year, the business was profitable and Duncan and his wife were well on the way to owning a successful, ongoing enterprise that will increase their personal wealth.

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



Other Investment Alternatives

You also can invest in other things that may not earn a dividend or interest but may rise in value over time, such as land, rare coins, antiques and art. If you are knowledgeable about these types of investments, they might be the right choice for you.

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

1. _____

2. _____

3. _____

4. _____

5. _____

We have seen that by budgeting to save, saving and investing, wealth can be created. But what if debt limits your ability to save and invest? The next chapter discusses controlling debt.

④ Build Credit; Control Debt

YOUR CREDIT HISTORY IS IMPORTANT

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

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

Mad Magazine

Remember the definition of net worth (wealth)?

Assets – Liabilities = Net Worth

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

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

KNOW WHAT CREDITORS SAY ABOUT YOU

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

The information in your credit report is used to create your ***credit score***.* A credit score is a number generated by a statistical model that objectively predicts the likelihood that you will repay on time. Employers, insurance companies, potential landlords, banks and other lenders use credit scores. The higher your score, the less risk you represent to the lender.

A credit report that includes late payments, delinquencies or defaults will result in a low credit score and could cause you to have to pay higher interest rates or be declined altogether. The most important factor in a

What's on YOUR Credit Report?

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

Equifax: 800-685-1111; www.equifax.com

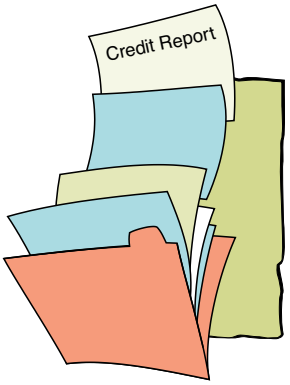
Experian: 888-397-3742; www.experian.com

TransUnion: 800-888-4213; www.transunion.com

The three nationwide consumer credit reporting companies have set up a toll-free telephone number and one central website for ordering free reports:

877-322-8228; www.annualcreditreport.com

*For a small fee, you can get your credit score from any of the three credit reporting companies or from www.myFICO.com.



credit score is the payment history. This history shows whether payments were made on time or late. Recent delinquent payments are more damaging, compared with late payments from many years past. Also, the severity of the delinquency is a factor. For example, a payment made 30 days late has less impact on your credit score than a payment made 60 days late. Another major factor in the credit score calculation is the amount owed on credit accounts. A recommended guideline is to keep your balance at less than half the total credit available on the credit line. This ***utilization rate*** is an important factor in the credit score calculation.

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

Know the Score

- The Federal Reserve Board publishes a guide to credit reports and scores for consumers: www.federalreserve.gov/creditreports
- The Federal Trade Commission outlines the steps to dispute credit report information and has a sample dispute letter available: http://ftc.gov/bcp/edu/pubs/consumer/credit/cre13.shtm

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

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

But how do you establish a credit history if you've never used credit? Consider a ***secured credit card***. This type of card will require a deposit, usually equal to your credit limit. After you have used the secured credit card for a year or more, never maxing out your credit and always paying on time, the credit card provider will typically offer an unsecured card. Another type of starter account may be a retail store card or gas card. Before you apply, make sure the card provider will report payments to the credit reporting companies. Some cards, such as ***prepaid debit cards***, do not report payments to the credit reporting companies. If you decide you no longer need a credit account, pay it off and stop using it, but don't close the account. You need those older accounts to show you have a long history of paying on time.

Tips for Building Good Credit

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

TAKING ON DEBT

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

The Tale of Two Spenders and the Big-Screen TV

Remember Betty? She saved up for the "extras." When she had enough money in her savings account, she bought a big-screen TV for $1,500. She paid cash.

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

While Betty paid only $1,500 for her big-screen TV, Tim paid $2,200—the cost of the TV plus interest. Tim not only paid an extra $700, he lost the opportunity to invest the $700 in building his wealth.

Are You Ready to Take On a Credit Obligation?

If you don't have a budget, or spending plan, you're not ready to take on debt. Before taking on credit obligations, it's very important to have a good foundation, including your emergency savings, a budget, your financial records and goals, and insurance to protect your assets. See the Investment Pyramid on page 11. Do you have a strong financial foundation?

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

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

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

TAKE STEPS TO CONTROL YOUR DEBT

To manage debt, you need to know how much you have and develop strategies to control it. When Bob decided to reduce his $3,000 credit card debt, he analyzed his debt, developed a strategy and took action:

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

Credit card	Debt	Interest rate	Monthly interest*
Department Store A	$ 500	19.5%	$ 8.13
XYZ Bank	$1,250	17%	$ 17.71
BHA Finance Co.	$1,000	22%	$ 18.33
Store B	$ 250	15%	$ 3.13
Total	$3,000		$ 47.30

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

Credit card	Debt	Interest rate	Monthly interest
Total			

What is your credit card debt situation? Using the chart to the left, do an analysis of your own.

My strategy for reducing credit card debt includes:

1. _____

2. _____

3. _____

SAVE MONEY BY CHOOSING THE RIGHT LOAN

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

$15,000 Car Loan for 5 Years		
Lender	Interest rate	Total interest
Pixley Bank and Trust	6.5%	$2,609.53
XYZ Savings and Loan	7.5%	$3,034.15
Joe's Auto Sales	15.0%	$6,410.94

Shop and negotiate for the lowest interest rate. The interest you save can be invested to build wealth. Take a look at the chart to the left. It may be obvious which lender will charge the lowest interest. What's not obvious is that your credit score may determine which interest rate you are offered. Obtain your credit score well before you plan to apply for a loan. Use an online auto loan calculator to compare rates.

SAVE MONEY BY PAYING LOANS OFF EARLY

You can save interest expense by increasing your monthly payments or choosing a shorter payment term on your loan.

$15,000 Car Loan at 6.5 Percent Interest			
	3-year	4-year	5-year
Number of payments	36	48	60
Payment	$ 460	$ 356	$ 293
Total paid	$ 16,550	$ 17,075	$ 17,610

Betty, the doer, knew her new car would cost more than the sticker price because she would have to pay interest on the loan from the bank. After checking her options, she chose a shorter payment term with higher payments. Betty budgeted enough money each month to make the higher payments. By doing this, she will reduce the amount of interest she ultimately pays.

The chart on the left shows how shorter terms with higher payments would affect the total amount and interest on Betty's $15,000 car loan.

BEWARE OF PAYDAY LOANS AND OTHER HIGH-COST CREDIT

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

Pauline

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

Pauline's children discovered her situation and paid off the loan. The lessons here are:

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

KEEP YOUR GOOD NAME

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

GUARD YOUR IDENTITY

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

Some Tips to Protect Your Identity:

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

⑤ Protect Your Wealth

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

Mahatma Gandhi

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

PROPERTY INSURANCE

Auto Insurance

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

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

Home Insurance

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

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

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

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

HEALTH INSURANCE

Medical Insurance

Medical insurance pays for some, but not all, of your doctor, hospital and prescription drug costs. Many people have significant levels of debt because they didn't have medical insurance or they didn't have savings to pay the expenses that weren't covered by their health plan. Late payments and defaults on medical debt may be reported on credit reports and affect a person's credit score.

Premiums are lower on employer-provided health insurance because risk is spread over a larger group of people. Take advantage of the lower costs that employer-sponsored health plans offer, but expect to pay part of the premium out of your paycheck. In addition to medical insurance, many employers offer dental and vision plans, often at low cost.

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

If you have health insurance and your employer doesn't offer a flexible spending account, you should make sure your emergency savings account is adequate to provide a safety net against unexpected medical costs.

Health savings accounts. If you do not have health insurance or you need more affordable insurance, a high-deductible health plan (HDHP), coupled with a health savings account (HSA), provides medical insurance coverage and a tax-free opportunity to save for future medical needs. The premium for an HDHP is generally lower than for traditional health insurance because the deductible (the amount you pay before the insurance kicks in) is higher.

That's where the health savings account comes in. HSAs are set up at banks or other financial institutions to pay for current and future health-related costs that occur before the deductible is met and insurance takes over. Contributions to an HSA are tax-deductible, up to certain limits, even if you do not itemize deductions on your income tax return. Interest earned on the HSA account is not taxable, and withdrawals are tax-free if used for qualified medical expenses. An HSA is portable, so it stays with you even if you change jobs or retire. Plus, unspent savings in an HSA can grow year-to-year.

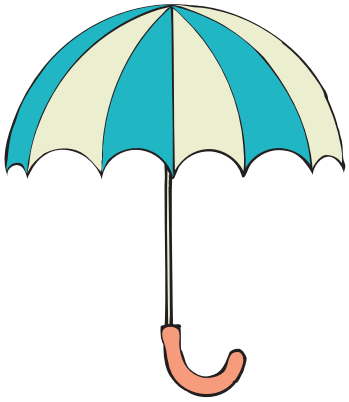
For more information about HSAs, go to www.treasury.gov/offices/public-affairs/hsa.

Health insurance for children. Every state provides free or low-cost health insurance for children in low- to moderate-income households. For more information about state programs, contact the U.S. Department of Health and Human Services at 877-Kids Now (877-543-7669) or go to www.insurekidsnow.gov.

Disability Insurance

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

LIFE INSURANCE



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

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

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

LONG-TERM CARE INSURANCE

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

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

Tips for Protecting Your Wealth

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

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

Buy Insurance Wisely

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

Review

Redefining Wealth

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

Resetting Your Financial Goals

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

Using Key Wealth-Building Strategies

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

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

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

Wealth is:

_____

_____

_____

_____

_____

My short-term goals are:

1. _____
2. _____
3. _____

My long-term goals are:

1. _____
2. _____
3. _____

My strategies for building wealth are:

1. _____
2. _____
3. _____

My strategies for building credit and controlling debt are:

1. _____
2. _____
3. _____

Clip the box and put it where you will see it often: inside your checkbook, on your computer monitor, where you pay your bills, on your bathroom mirror. Keep your definition of wealth and your goals firmly implanted in your mind and use your wealth-creating and debt-controlling strategies every day.

Glossary

Accrued interest Interest that has been earned but not received or recorded.

Amortization Liquidation of a debt by making periodic payments over a set period, at the end of which the balance is zero.

Annual percentage rate (APR) The annual rate that is charged for borrowing (or made by investing), expressed as a single percentage number that represents the actual yearly cost of funds over the term of a loan. The APR includes any fees or additional costs associated with the transaction.

Appreciation An increase in the value or price.

Asset Anything an individual or business owns that has commercial or exchange value.

Auto debit The deduction from a checking or savings account of funds that are automatically transferred to a creditor each month. Some lenders offer interest rate discounts if loan payments are set up on auto debit at the beginning of the loan.

Balance The amount owed on a loan or credit card or the amount in a savings or investment account.

Balance sheet A financial statement showing a "snapshot" of the assets, liabilities and net worth of an individual or organization on a given date.

Bankruptcy A legal proceeding declaring that an individual is unable to pay debts. Chapters 7 and 13 of the federal bankruptcy code govern personal bankruptcy.

Beneficiary The person designated to receive the proceeds of a life insurance policy.

Budget An itemized summary of probable income and expenses for a given period.

Capital Cash or other resources accumulated and available for use in producing wealth.

Cash flow Money coming to an individual or business less money being paid out during a given period.

Certificate of deposit (CD) A type of savings account that earns a fixed interest rate over a specified period of time.

Collateral Assets pledged to secure a loan.

Common stock A kind of ownership in a corporation that entitles the investor to share any profits remaining after all other obligations have been met.

Compound interest Interest computed on the sum of the original principal and accrued interest.

Credit The granting of money or something else of value in exchange for a promise of future repayment.

Credit card A plastic card from a financial services company that allows cardholders to buy goods and services on credit.

Credit report A loan and bill payment history, kept by a credit reporting company and used by financial institutions and other potential creditors to determine the likelihood a future debt will be repaid.

Credit reporting company An organization that compiles credit information on individuals and businesses and makes it available for a fee.

Credit score A number generated by a statistical model that objectively predicts the likelihood that a debt will be repaid on time.

Credit union A cooperative organization that provides financial services to its members.

Creditor A person, financial institution or other business that lends money.

Debit Charges to an account.

Debit card A plastic card similar to a credit card that allows money to be withdrawn or the cost of purchases paid directly from the holder's bank account.

Debt Money owed; also known as a *liability*.

Debt service Periodic payment of the principal and interest on a loan.

Deductible The amount of loss paid by an insurance policyholder. The deductible may be expressed as a specified dollar amount or a percent of the claim amount.

Delinquency The failure to make timely payments under a loan or other credit agreement.

Direct deposit The electronic transfer of a payment from a company to an individual's checking or savings account. Many employers offer direct deposit of paychecks.

Diversification The distribution of investments among several companies to lessen the risk of loss.

Dividend A share of profits paid to a stockholder.

Equity Ownership interest in an asset after liabilities are deducted.

Face value The principal amount of a bond, which will be paid off at maturity.

Fair market value The price a willing buyer will pay and a willing seller will accept for real or personal property.

Federal Deposit Insurance Corp. (FDIC) A f ederally chartered corporation that insures bank deposits up to $250,000.

Finance charge A fee charged for the use of credit or the extension of existing credit. It may be a flat fee or a percentage of borrowings. The finance charge may include the cost of carrying the debt itself along with any related transaction fees, account maintenance fees or late fees charged by the lender.

Finance company A company that makes loans to individuals.

Financing fee The fee a lender charges to originate a loan. The fee is based on a percentage of the loan amount; one point is equivalent to 1 percent.

Flexible spending account An employer-sponsored account that allows employees to save pretax dollars to cover qualified medical or dependent care expenses.

Foreclosure The legal process used to force the payment of debt secured by collateral whereby the property is sold to satisfy the debt.

401(k) plan A tax-deferred investment and savings plan that serves as a personal retirement fund for employees.

Health savings account A tax-advantaged personal savings account, set up to be used exclusively for medical expenses; must be paired with a high-deductible health insurance policy.

High-deductible health plan A health insurance policy that requires the policyholder to pay more out-of-pocket medical expenses but usually has lower premiums than traditional health insurance plans.

Individual development account (IDA) A type of savings account, offered in some communities, for people whose income is below a certain level.

Individual retirement account (IRA) A retirement plan, offered by banks, brokerage firms, mutual funds and insurance companies, to which individuals can contribute each year on a tax-deferred basis.

Inflation A sustained increase in the prices of goods and services.

Installment plan A plan requiring a borrower to make payments at specified intervals over the life of a loan.

Insurance premium The amount of money required for coverage under a specific insurance policy for a given period of time. Depending on the policy agreement, the premium may be paid monthly, quarterly, semiannually or annually.

Interest A fee for the use of money over time. It is an expense to the borrower and revenue to the lender. Also, money earned on a savings account.

Interest rate The percentage charged for a loan, usually a percentage of the amount lent. Also, the percentage paid on a savings account.

Investing The act of using money to make more money.

Investor An organization, corporation, individual or other entity that acquires an ownership position in an investment, assuming risk of loss in exchange for anticipated returns.

Leverage The ability to use a small amount of money to attract other funds, including loans, grants and equity investments.

Liability Money an individual or organization owes; same as debt. Also, a kind of insurance for the policyholder's legal obligation to pay for either bodily injury or property damage caused to another party.

Lien A creditor's claim against a property, which may entitle the creditor to seize the property if a debt is not repaid.

Liquidity The ease with which an investment can be converted into cash.

Load The fee a brokerage firm charges an investor for handling transactions.

Loan A sum of money lent at interest.

Management fee The fee paid to a company for managing an investment portfolio.

Market value The amount a seller can expect to receive on the open market for merchandise, services or securities.

Maturity The time when a note, bond or other investment option comes due for payment to investors.

Money market account A type of savings account offered by a financial institution.

Mortgage A temporary and conditional pledge of property to a creditor as security for the repayment of a debt.

Municipal bond A bond issued by cities, counties, states and local governmental agencies to finance public projects, such as construction of bridges, schools and highways.

Mutual fund A pool of money managed by an investment company.

Net worth The difference between the total assets and total liabilities of an individual.

Par value The nominal, or face, value of a stock or bond, expressed as a specific amount on the security.

Payday loan A loan taken out against the borrower's paycheck. In exchange for money, the borrower writes a postdated check. This type of loan generally comes with a very high interest rate.

Predatory lending Targeting loans to seniors, low-income and other people to take advantage of their financial status or lack of financial knowledge.

Prepaid debit card An alternative to traditional debit cards that are tied to a checking account, prepaid debit cards are typically tied to a direct deposit or a savings account. These cards charge monthly fees and/or usage fees and do not report payments to the credit reporting companies.

Pretax A person's salary before state and federal income taxes are calculated.

Prime rate The lowest interest rate on bank loans, offered to preferred borrowers.

Principal The unpaid balance on a loan, not including interest; the amount of money invested.

Promissory note A written promise on a financial instrument to repay the money plus interest.

Qualified plan A tax-deferred retirement plan for the self-employed.

Return The profit made on an investment.

Revenue bond A type of municipal bond backed by revenue from the project the bond finances.

Risk The possibility of loss on an investment.

Savings account A service depository institutions offer whereby people can deposit their money for future use and earn interest.

Secured credit card Requires a cash deposit that becomes the credit line. Secured credit cards are offered by many banks and credit unions and usually report payments to the credit reporting companies. Charges typically include an annual fee and higher interest rates than unsecured credit cards.

Stock option The right to buy or sell a corporation's stock at a predetermined price or calculable formula; sometimes used as part of employee compensation.

Stockholder A person who owns stock in a company and is eligible to share in profits and losses; same as *shareholder*.

Tax-deferred Phrase referring to money that is not subject to income tax until it is withdrawn from an account, such as an individual retirement account or a 401(k) account.

Term The period from when a loan is made until it is fully repaid.

Terms Provisions specified in a loan agreement.

Treasury bill A short-term investment issued by the U.S. government for a year or less.

Treasury bond A government security with a term of more than 10 years; interest is paid semiannually.

Treasury Inflation-Protected Security (TIPS) A Treasury bond or note that is tied to inflation so that the principal amount of the investment increases or decreases according to the annual inflation rate.

Treasury note A government security with a maturity that can range from two to 10 years; interest is paid every six months.

U.S. savings bond A nontransferable, registered bond issued by the U.S. government in denominations of $50 to $10,000.

Utilization rate For credit cards, the percentage of an available credit line that is being used. Current account balance / available credit = utilization rate

Wealth-Building Resource Guide

INTRODUCTION

The following resources can be used to learn more about building personal wealth. The list includes sources of information on financial literacy for adults and youth, budget and debt management, and consumer protection. This guide is not intended to be all-inclusive; there are many additional national, state and local resources that can provide additional information on building wealth for a more secure financial future.

PERSONAL FINANCIAL EDUCATION

AARP
(888) 687-2277
www.aarp.org

America Saves
(202) 387-6121
www.americasaves.org

American Bankers Association Education Foundation
(800) 226-5377
www.aba.com/abaef/consumers.htm

American Council of Life Insurance
(202) 624-2000
www.acli.com

American Financial Services Association Education Foundation
(202) 296-5544
www.moneyskill.org

American Institute of Certified Public Accountants
(888) 777-7077
www.360financialliteracy.org

American Savings Education Council
(202) 659-0670
www.choosetosave.org

The Beehive/One Economy
(202) 393-0051
www.thebeehive.org

CFED
(202) 408-9788
www.cfed.org

Fannie Mae
(202) 752-7000
www.fanniemae.com

Federal Citizen Information Center
(800) 878-3256
www.consumer.gov
www.pueblo.gsa.gov

Federal Deposit Insurance Corporation
(877) 275-3342
www.fdic.gov/consumers/consumer/moneysmart

Federal Reserve Board
(212) 720-6134
www.federalreserveeducation.org

Freddie Mac
(703) 903-2000
www.freddiemac.com
www.freddiemac.com/creditsmart
www.freddiemacfoundation.org

Internal Revenue Service
(800) 829-1040
www.irs.gov

Louisiana Cooperative Extension
(225) 578-4161
www.lsuagcenter.com

State of Louisiana – Office of Financial Institutions
(225) 925-4660
www.ofi.state.la.us

National Credit Union Administration
(703) 518-6340
www.mycreditunion.gov

National Endowment for Financial Education
(303) 741-6333
www.nefe.org
www.smartaboutmoney.org

New Mexico Regulating and Licensing Department Financial Institutions Division
(505) 476-4885
www.rld.state.nm.us/FID

DIRECT DEPOSIT & YOU

Many people who receive federal benefits checks, such as Social Security, Supplemental Security Income, Veterans Affairs or other government checks, enroll in direct deposit. Not only is it safer (no direct deposit has ever been stolen), it is far more convenient, and it gives you more control over your money than a mailed check. Call the toll-free Go Direct helpline at (800) 333-1795, or go to www.GoDirect.org for more information and other sign-up options.

ELECTRONIC TRANSFER ACCOUNT

For a low-cost option for direct deposit, consider an ETA account. The Electronic Transfer Account, or ETA℠, allows you to have your federal benefit, wage, salary and retirement payments deposited directly into your bank account—automatically, electronically and safely. Open a low-cost ETA at a federally insured bank, credit union, or savings and loan. Financial institutions offering the ETA have decals in their windows or lobbies identifying them as certified ETA providers. To find an ETA provider in your area, visit the ETA website, www.eta-find.gov, or call toll-free, (888) 382-3311.

New Mexico State University Cooperative Extension Service
(505) 646-2198
http://extension.nmsu.edu

Texas AgriLife Extension Service
(979) 845-7907
http://agrilifeextension.tamu.edu

Texas Department of Banking
(512) 475-1337
www.banking.state.tx.us/dss/fe.htm

Texas Society of CPAs
(800) 428-0272
www.valueyourmoney.org

U.S. Department of Agriculture Cooperative State Research, Education and Extension Service
(202) 690-2674
www.csrees.usda.gov

U.S. Department of Labor Women's Bureau
(800) 827-5335
www.wiseupwomen.org

U.S. Department of the Treasury
(800) 722-2678
www.treasurydirect.gov

U.S. Financial Literacy and Education Commission
(888) 696-6639
www.mymoney.gov

U.S. Social Security Administration
(800) 772-1213
www.ssa.gov

Women's Institute for Financial Education
(760) 736-1660
www.wife.org

Women's Institute for Secure Retirement
(202) 393-5452
www.wiserwomen.org

FINANCIAL EDUCATION – YOUTH

American Financial Services Association
(888) 400-7577
www.moneyskill.org

Banking on Our Future
(877) 592-4673
www.bankingonourfuture.org

Council for Economic Education
www.councilforeconed.org

Federal Reserve Board
(212) 720-6134
www.federalreserveeducation.org
www.federalreserve.gov/kids

Jump$tart Coalition for Personal Financial Literacy
(888) 453-3822
www.jumpstart.org

Junior Achievement
(719) 540-8000
www.ja.org

National Endowment for Financial Education
(303) 741-6333
www.nefe.org

North American Securities Administrators Association
(202) 737-0900
www.nasaa.org

Sallie Mae
(888) 272-5543
www.salliemae.com

Texas Council on Economic Education
www.economicstexas.org
www.smartertexas.org

U.S. Department of the Treasury Money Math
(800) 722-2678
www.treasurydirect.gov/indiv/tools/tools_moneymath.htm

BUDGET AND DEBT MANAGEMENT

Consumer Credit Counseling Services of Greater Dallas, Inc.
Locations in New Mexico, Texas and other states
(800) 249-2227
www.cccs.net

Consumer Credit Counseling Services, a division of Money Management International
Locations in Louisiana, New Mexico, Texas and other states
(713) 923-2227
www.cccsintl.org
www.moneymanagement.org

Credit Coalition Houston Area
(713) 224-8100
www.creditcoalition.org

CCCS of Greater San Antonio Austin, Laredo and San Antonio
(800) 410-2227
www.cccssa.org

Green Path Debt Solutions
www.greenpath.com

Homeowner's HOPE ™ Hotline
(888) 995-HOPE
www.995hope.org

National Foundation for Credit Counseling
Various locations across U.S., including Texas, Louisiana and New Mexico
(800) 388-2227
www.debtadvice.org
www.nfcc.org

Operation HOPE, Inc.
(877) 592-HOPE
www.operationhope.org

CONSUMER PROTECTION

Consumer Financial Protection Bureau
(855) 411-2372
www.consumerfinance.gov

Federal Deposit Insurance Corporation
(415) 808-8049
www.fdic.gov/consumers

Federal Reserve Consumer Help
www.federalreserveconsumer-help.gov
(888) 851-1920

Federal Trade Commission
(202) 326-2222
www.ftc.gov

Investor Protection Trust
(202) 775-2113
www.investorprotection.org

Louisiana Department of Insurance
(800) 259-5300
www.ldi.state.la.us

Louisiana – Office of the Attorney General
(800) 351-4889
www.ag.state.la.us

National Association of Insurance Commissioners
(816) 842-3600
www.insureuonline.org

National Consumer Protection Week
www.ncpw.gov

New Mexico Insurance Division
(800) 947-4722
www.nmprc.state.nm.us/id.htm

New Mexico – Office of the Attorney General
(800) 678-1508
www.nmag.gov

Securities and Exchange Commission
(800) 732-0330
www.sec.gov

Texas Department of Insurance
(800) 252-3439
www.tdi.state.tx.us

Texas – Office of the Attorney General
(800) 252-8011
www.oag.state.tx.us

Texas State Securities Board
(888) 663-0009
www.texasinvestored.org

BOOKS QUOTED IN PUBLICATION

Getting Rich in America: 8 Simple Rules for Building a Fortune and a Satisfying Life
Dwight R. Lee and
Richard B. McKenzie
1999, Harper Business

The Millionaire Next Door: The Surprising Secrets of America's Wealthy
Thomas J. Stanley
and William D. Danko
1996, Longstreet

We hope that you have found Building Wealth *to be a useful tool. We invite you to visit our website and send us your* Building Wealth *success stories.*

Richard W. Fisher, President and CEO
Federal Reserve Bank of Dallas

www.dallasfedbuildingwealth.org

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