THE

Pay, Save, Spend Rule

A Simple Guide For Your Financial Health And Peace Of Mind

About the AUTHOR

Kent Johnson is co-director of Consumer Credit of Minnesota (CCMN) and a certified credit counselor through The Institute for Financial Literacy.

Johnson has worked in the credit counseling and financial education industry for more than 20 years in Iowa and Minnesota. He also has taught courses in banking and insurance through Des Moines Area Community College.

He's been quoted in the general media and financial publications, including in The Des Moines Register and the book, "Dollars and Sense for College Students," published by the Princeton Review. He has also been seen on KARE-11 TVnews, the NBC affiliate in Minneapolis. He frequently gives financial education presentations through high schools, colleges, and churches, as well as civic and community organizations.

Johnson's focus is to provide financial education to people on the wise use of credit, the importance of savings, and making sound financial choices.

CCMN is an accredited, nonprofit credit counseling service that offers free and confidential credit and budget counseling sessions to review the options available to those who have debt concerns or need help developing a budget. CCMN is dedicated to helping people regain control of their personal finances. CCMN counsels, advises, and structures debt consolidation and repayment programs for its customers.

CCMN's debt consolidation and repayment programs, as well as its educational efforts and outreach, touch hundreds of individuals and families each year. Its highly reputable, fair-minded counselors can provide direct financial assistance through debt management plans, which return more than $50 million a year to creditors. A key goal is to help clients regain financial self-sufficiency while avoiding bankruptcy and ultimately becoming debt-free.

Printed by Consumer Credit of Minnesota Publications
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Start On Your Way To Financial PEACE OF MIND

Being "financially healthy" doesn't necessarily mean being wealthy. Being financially healthy is having peace of mind, knowing your debt is under control, having savings in the bank for a rainy day, and spending money wisely in a way that is guilt-free.

Sometimes we wrongly assume that excessive debt and worry is just a way of life. About 15 years ago I attended my nephew's high school graduation, at which he was the student speaker. Next to speak was the principal, who preached to the graduates about how hard life would be after graduation, including taking on student loan debt, car payments, house payments, and "being buried in credit card debt." After I heard this, I wondered if I missed something! Did the principal say *all* the students would be in credit card debt? Yes, she did! I was astounded.

The fact is this principal's defeatist assumption just isn't true. Currently, 40 percent of all credit card users—nearly half—pay off their balance in full each month. Also, studies show that almost 70 percent of those who have experienced financial troubles eventually resolve their financial issues. And they actually become better money managers as a result.

These financially healthy people aren't necessarily any smarter or richer than you or I. So if you're not in that 40 percent category, take heart that you can be.

In the following pages, you'll find useful tips on the rules of reducing debt, managing your budget, and guilt-free spending. The basis of this is breaking your budget into three parts—one for paying fixed costs, saving what is needed, and then spending the remainder on items over which you have some control.

Whether you're in debt looking for a way to get out, or you're just looking to manage your finances better to stay out of debt, you'll find the information in this financial resource booklet to set you on the path to financial health for years to come. Let's get started!

Kent Johnson

Kent Johnson

Almost 70 percent of those in financial trouble are able to resolve their money troubles and manage their finances better.

HOW MUCH DO YOU KNOW ABOUT SMART MONEY MANAGEMENT?

Before you read this book, test your knowledge with a quick quiz.

1. **Saving money is important so we can**
   A) prepare for emergencies
   B) avoid credit card debt
   C) all of the above

2. **Credit cards are useful financial tools because we can**
   A) use them to build credit
   B) spend money when there's no money in our bank account
   C) use them as a form of savings

3. **Monthly debt payments, including a mortgage, should not exceed**
   A) 20 percent of your net income
   B) 40 percent of your gross income
   C) 40 percent of your net income

4. **Borrowing from your home using a home equity loan is generally not advisable unless**
   A) used for home improvement
   B) you use the money to pay off your credit cards
   D) both A and B

5. **If you pay your credit card debt in full each month you will**
   A) not build credit history
   B) not pay interest
   C) both A and B

6. **Borrowing from your 401K retirement account is**
   A) wise because you pay yourself back
   B) a good idea when you need money for a vacation or a car repair
   C) not a good idea because you will have less money when you retire

7. **Transportation expenses, including car payments, insurance, and gas, shouldn't exceed**
   A) 40 percent of your gross income
   B) 40 percent of your net income
   C) 20 percent of your net income

8. **Those paying their way out of a great deal of debt should**
   A) not save
   B) pay no more than the monthly minimum payments
   C) develop a budget so they know when to expect to be debt free

9. **Factors affecting credit scores include**
   A) payment history
   B) how much you owe versus how much credit you have available
   C) both A and B

10. **Being "maxed out" on your credit cards will**
    A) improve your credit score
    B) decrease your credit score
    C) not impact your credit score

ANSWERS: 1. C, 2. A, 3. C, 4. A, 5. B, 6. C, 7. C A, 8. C, 9. C, 10. B.

QUIZ

It All Starts With A BUDGET

Don't be put off by a budget. It's simply a way to wrap your head around what you earn and spend—and it's essential to gaining control of your financial life.

Many of us have similar financial goals—reducing our debt, buying a new car or house, or saving for a vacation. When we are young, our financial goals may be pretty simple, such as paying bills and avoiding debt. As we grow older, our goals become more ambitious, such as attaining a certain lifestyle, moving into our dreamhouse, or funding a comfortable retirement.

Whatever financial goals we have, at whatever stage of our lives, to achieve those goals, we must start with a sound and realistic budget.

A SYSTEM TO MAKE THE NUMBERS WORK

When creating a budget, it can be tough to make sure that expenditures aren't greater than income. Some tips:

- Have you considered every bill and spending category in your budget?
- Have you been tracking your monthly expenses? Knowing how much you spend is the first step to reducing or altering spending—often with minimal pain.
- Have you been saving for emergencies or periodic expenses? If not, they can wreak havoc with your monthly budget. Savings allows you to smooth out those problems and stay on track.
- Reduce costs of anything that's not necessary, or eliminate it altogether.
- If you can't cut expenditures any more, consider increasing income, such as taking on a part-time job.

HOW TO CREATE A BUDGET THAT WORKS FOR YOU

A sound budget is necessary for anyone who earns or collects money, but it certainly doesn't have to be complex, by any means.

Some people find they need detailed budgets on their computers or paper to keep track of what they take in and spend. Others keep rough budgets in their heads. We all have our own system of budgeting.

The issue is whether it works for you or not. Ask yourself the following questions. If you answer "no" to any of them, your system of budgeting could use some adjustment.

- Do I have enough money to pay for my basic, fixed needs, such as rent or the house payment, car payments, utilities, and child care?
- Do I have enough on hand to cover emergencies, such as a job loss, medical emergency, or reduction of income?
- Do I have enough money to pay for those periodic expenses that arise, such as car maintenance, medical bills, or large home repairs?
- Am I saving instead of borrowing for purchases that are important to me, such as a home improvement project or vacation?
- Overall, do I have a good idea of how much I need to spend each month on myself or my family?

SMART MONEY TIP: Small budget trims can make a big difference. For example, packing your work lunch two or three times a week can save a surprising amount of money.

SAVINGS
A Necessity, Not A Luxury

A key element to financial health is a savings account. It provides that critical cushion between you and a financial crisis.

In this book, you'll hear a lot about savings. That's because one of—if not *the* most important elements of money management and financial health is savings.

While some people think of savings as a nice, extra bonus when they have money left over, the truth is that savings is an absolute necessity—not a luxury. These people don't see the need for savings. They believe they can use their credit cards to cover emergencies or other unexpected financial needs.

And that's a problem.

The Number One Cause Of Financial Problems

I've been a financial counselor for many years, and when people ask me to name the main cause of most people's financial troubles, the answer is easy: A lack of savings.

Sure, the specific reason may be a job loss, medical hardship, a divorce, or a cut in pay, but the true, underlying reason is that the people who encountered these problems—and we all encounter them at one point or

SMART MONEY TIP: Even simply creating a plan to save is an important first step to actually begin saving.

another—is that these people did not have a savings account to buffer the financial unexpected.

I don't want to sound insensitive. I've worked with people who have done things right and saved the right amount of money, but financial hardship depleted their savings. However, consider how much worse their circumstances would be if they didn't have any savings at all.

No Savings Sets You Up For Credit Card Problems

When people don't have a savings account to turn to, they turn to credit cards. Then they get into the whole credit card trap, with rising balances and interest payments. Then at some point, they end up eliminating the ability to save anything at all.

Using credit cards as your backup for emergencies sets you up for real financial problems. Some might think that credit cards are good for emergencies because they can use them anywhere in almost any way, including out of town.

That may be true, but if you have a savings account, once you're home, you can then pay off that credit card instead of having to carry a balance—plus the additional interest.

Also, too often, what people define as "emergencies" are actually expenses that should be expected and planned.

A good example is a car repair. If you have a vehicle more than a few years old, you should have enough money in savings to cover even a major repair, as well as some of the other financial curveballs life always seems to throw our way.

But I'm Too Hard Up To Save!

Of course, you may be thinking, "But I'm experiencing real financial hardship. There's no way I can start saving! I can't even cover my current expenses!"

Believe me, I have experienced some tough financial times myself, so I understand. But in that case, set up a plan to be able to *start* to save. Make it a goal—and you'll be taking the first step to achieving that goal.

SIMPLE SAVINGS TIP

If it's hard to discipline yourself to set aside savings, set up an automatic deduction from your checking account into a savings account. You won't have a choice!

The PAY, SAVE, SPEND Rule

Stop looking at your income as a lump sum. Instead, break it into three easy categories that set you on your way so you can PAY your bills, SAVE what you need, and SPEND without guilt.

Many of us visualize our money as a chunk of income that comes to us on specific dates each month. We deposit it into our checking account and from there, we pay our monthly bills and expenses. We try to save anything that's left over.

For many people, this is the extent of their budgeting. Savings is often thought of as "luxury money" or a "bonus." So despite their good intentions, they don't save the way they need to.

Well, that's where The Pay, Save, Spend Rule comes in. It helps you budget your income to help you meet your needs, wants, and goals. Here's how it works:

Sit down with pencil and paper and write down three categories: Pay, Save, Spend.

1. In the **Pay** category, put those items that you must pay each month—your regular monthly bills.

2. Once you've figured out how much you need each month just to cover your must-pay bills, you now have a better idea what you have to **Save**. In this category, put those larger, periodic items for which you *need* to save to cover—such as car repairs and periodic life insurance—and for which you would *like* to save—the extras.

3. In the **Spend** category, put those items for which you have some discretion and flexibility on how much you spend.

Depending on your lifestyle, some might go into either the Pay or Spend category. For example, prescriptions would go into Pay if they're a regular, set expense. They'd go into Spend category if they're occasional or varying items.

See pages 8-13 for more details and specifics on what goes into which category.

SMART MONEY TIP: One way to track expenses is to put all receipts for the month into an envelope and then categorize and total them at the end of the month.

PAY 1

These are regular, fairly fixed bills that you must PAY each month.

- Rent or mortgage
- Utilities, such as gas, electric, water, garbage
- Phones, cell phones, Internet, cable
- Car payment
- Car and/or life insurance (if monthly)
- Homeowners insurance (unless escrowed)
- Student loans
- Daycare
- Other loans or credit card payments
- Any other bills you pay monthly either by writing a check, automatic transfer, or online

See page 10 for more details.

SAVE 2

List the items both that you MUST SAVE for and also the items you WANT TO SAVE for. These are expenses that occur periodically, such as home repairs or semi-annual car insurance. Items that you would like to or want to save for include "extras" such as vacations.

Savings Musts

- Retirement
- Major emergencies, such as job loss, medical hardship, or income reduction
- Car maintenance
- Home repairs and projects
- Periodic car, life, homeowner's or other insurance
- A down- or full payment for your next vehicle purchase

Savings Wants

- Vacation or long weekend getaways
- Holiday spending
- College for our children
- Any major purchase or "special something" for you or your family

See page 11 for more details.

SPEND 3

After you've figured what you need to PAY each month and what you need to SAVE, you'll have a better idea of what you have left to SPEND. These are items that can vary each month and for which we have some control.

- Groceries
- Gasoline
- Entertainment/meals out
- Haircuts and haircare
- Clothing
- Weekend trips
- Birthday gifts
- Dry cleaning
- Non-food grocery or household items
- Medical expenses, prescriptions
- Hobbies, lessons, sports
- Church or charity

See page 13 for more details.

How To PAY Your Bills

With The Pay, Save, Spend rule, each month, you PAY your regular, fixed bills first.

Each month, we have a set group of bills that absolutely must be paid or we'll experience fines, unpleasant reminder letters, or even phone calls from those companies that we owe money to.

With The Pay, Save, Spend rule system, these regular monthly bills and expenses are considered fixed items. They include rent or mortgage, utilities, phones, cable, car payments, various insurance payments, student loan and other loan payments, childcare, and any regular medical bills or prescriptions.

SETTING UP ACCOUNTS FOR THE PAY, SAVE, SPEND RULE

To keep track of your money for The Pay, Save, Spend Rule, I suggest that you physically separate the money into separate accounts or otherwise organize how you move your money.

The Pay Account: Consider having a checking account to pay your bills. Put into that only the funds you need to pay your monthly bills. Or take care of all those bills with automatic deductions or bill-paying.

The Save Account(s): Consider having more than one savings account—perhaps one for your savings musts and one for your savings wants.

The Spend Account: For this, consider a second checking or savings account that you access only with a debit card.

If you don't like the mechanics of having three accounts, you can use your checking and savings accounts as you would otherwise, but withdraw a weekly cash allowance for your spending and limit yourself to this set weekly amount.

SMART MONEY TIP: Use a combination of checking and savings accounts, as well as debit cards, to separate your bills, savings, and expenditures.

PAY

How To SAVE For What You Need And Want

Adequate savings are truly achievable when you use The Pay, Save, Spend Rule.

When it comes to savings, there's an old saying that advises you to "pay yourself first." It's a good idea, but The Pay, Save, Spend Rule adjusts it a bit and improves upon it.

Everyone wants to save, but the difficulty comes in actually creating those savings. Also, it can be difficult to figure out how much savings you should have.

So how much can you and should you *realistically* save each month?

As a rule of thumb, you should aim to save at least 10 percent of your monthly net income. However, for many, just 5 percent may be more realistic—especially if you are just getting into the savings habit. Then, as you experience success in saving 5 percent, increase it to 10 percent.

As part of The Pay, Save, Spend Rule, you've been asked to break your savings down into your savings "musts" and your savings "wants"

Savings Musts

■ **Retirement.** If your employer offers a 401K, 403B or any other retirement plan, start contributing if you haven't already, especially if you could receive a company match. This is usually the best option around for building retirement savings. Make it your goal to "max out" the amount you're allowed to give.

Otherwise, there are other "products" available to build retirement savings, such as IRAs. Find a reputable financial advisor who can guide you in this decision. Look for a Certified Financial Planner or a certified Personal Financial Specialist.

■ **Long-term emergencies.** These include job loss, medical hardship, or a cut in pay or income. Saving the equivalent of three to six months of your monthly net income is advisable.

So if your monthly net is $2,000 per month, you would save $6,000 to $12,000. Many people are pretty overwhelmed by these numbers,

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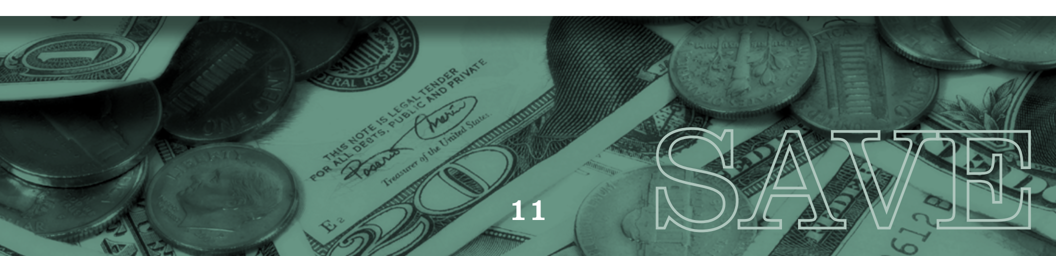

How To **SAVE** For What You Need And Want

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so I suggest just going for building the equivalent of one month's income to start. It may take several months or a few years to save this amount of money, but it's definitely a number to shoot for. Trust me, you'll sleep better at night knowing you have a safety net.

- **Periodic expenses.** There are those expenses that we all experience from time to time that put a crunch in our monthly income.

If you have a car, you'll need regularly to pay for oil changes and routine maintenance. If you have a house, you know the roof will last only so long. Or you may have car insurance or other bills that are paid semi-annually. Then there are the other expenses, such as the car breakdown or the big plumbing bill.

THE POWER OF THE CAN

Don't underestimate the simplicity and effectiveness of saving money in a can or jar. Tucking in a $10 or $20 regularly for a specific purchase adds up. I'm saving for new guitar!

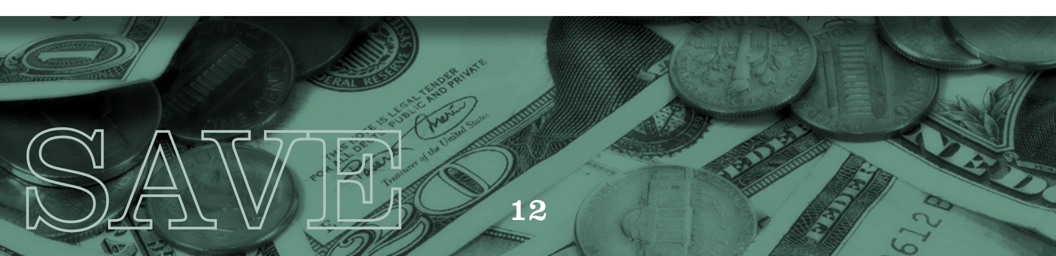
Savings Wants

Savings are important to make sure you are financially safe and secure, but they're also important to allow us to pay for a few nice things for ourselves or our family.

Too many people pay for these extras with credit cards or by getting behind on other bills. Instead, save at least small amounts to cover these expenses—and feel so much better about it in the bargain.

Consider the example of a vacation. If we save for it, we're likely to enjoy the vacation so much more than if we have to borrow for it. We want to relax and enjoy the time during and after our trip, rather than feeling that little bit of guilt for using borrowed money and being required to make payments for the trip long after it's over.

You might, for example, want to save for an expensive television or kitchen renovation. You'll also enjoy those much more knowing that you purchased them in the most financially responsible way possible.



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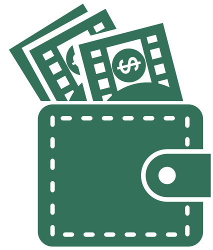
How To SPEND The Rest



After you've paid your bills and set aside savings, it's time to determine how much you can spend on discretionary items such as groceries, gas, clothing, hobbies, and gifts.

This category covers all those items that we purchase each month but for which we have some ability to control how much we spend.

A good example is groceries. Obviously, we all need to eat each month, but some people can get by on very little and others spend a small fortune.

Other Spend items vary widely depending on our lifestyle and preferences. Some may spend far more than average on clothing, for example, and afford themselves the ability to do so because far less is spent in other categories. The goal here is to know what you have to spend after you know your bills are paid and your savings account is fed. I know many people who might earn approximately the same income, but have widely varying degrees of spending in certain categories.

HOW MUCH TO SPEND

Use the power of the Internet to figure out how much to spend in different categories.

I get a lot of questions on what is a reasonable amount to spend for groceries. A good resource is the U.S. Department of Agriculture's web site *www.cnpp.usda.gov.* It lists current U.S. averages for groceries at four levels ranging from thrifty to liberal, for a variety of family sizes, updated monthly.

Here's a 2012 example for a single 19-50 year old female per month:

Thrifty: $161.90
Low Cost: $204.20
Moderate Cost: $252
Liberal: $321.20

A Monthly Expenses WORKSHEET

Use this handy format to calculate how much you Pay, Save, and Spend each month.

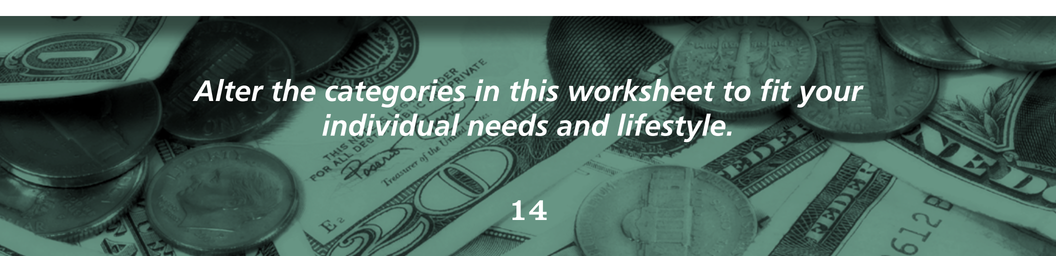
MONTHLY BUDGET WORKSHEET

1 PAY ITEMS

Those expenses that you must pay a roughly set amount for each month:

Rent or mortgage	____________
Utilities, such as gas, electric, water, garbage	____________
Phones, cell phones, internet, cable	____________
Car payment	____________
Car and/or life insurance (if monthly)	____________
Homeowners insurance (unless escrowed)	____________
Student loans	____________
Daycare	____________
Other loans or credit card payments	____________
Any other bills you pay monthly either by writing a check, automatic transfer, or online.	____________
Pay Items Subtotal:	____________

Note: *Some people like to put fixed savings, such as funds going to a retirement account, into this Pay category.*



Alter the categories in this worksheet to fit your individual needs and lifestyle.

2 SAVE ITEMS

These are the items for which you need to save each month:

Savings Musts:		Savings Wants:	
Category 1	______________	Category 1	______________
Category 2	______________	Category 2	______________
Category 3	______________	Category 3	______________
Category 4	______________	Category 4	______________

Save Items Subtotal: ______________

3 SPEND ITEMS

Those expenses that you have more discretion over:

Groceries	______________
Gasoline	______________
Entertainment and meals out	______________
Haircuts and haircare	______________
Clothing	______________
Weekend trips	______________
Birthday gifts	______________
Dry cleaning	______________
Non-food grocery or household items	______________
Medical expenses, prescriptions	______________
Hobbies, lessons, sports	______________
Church or charity	______________

Spend Items Subtotal: ______________

The Pay, Save, Spend Items Total: ______________

Monthly Income Total: ______________

The Rules Of BORROWING

Sometimes it's wise to borrow money, but sometimes it's not. Follow these guidelines when considering a loan.

Borrowing must be done only for those items that are extremely important or are not achievable any other way, such as for a home or education. Then there are times when borrowing money is not only justified, but is actually wise—as long as certain rules are followed.

Paying for items with cash or from savings is strongly recommended. But of course exceptions apply for those big-ticket items already mentioned. Other sound reasons to borrow might be to start a business or purchase a vehicle (provided there is a significant down-payment).

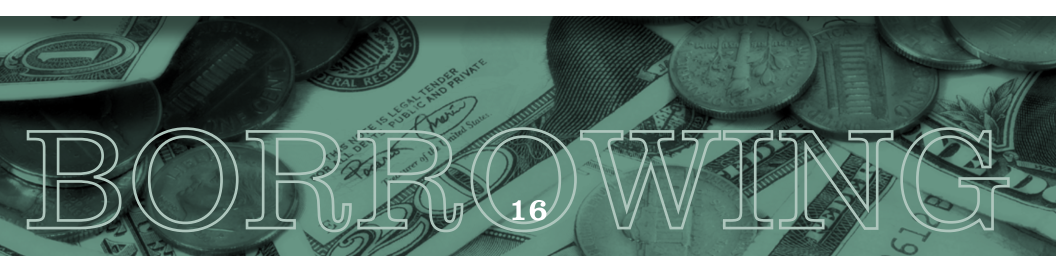
Some rules of thumb to keep in mind when considering a loan:

■ **Mortgages.** A monthly mortgage payment, including property taxes and insurance, should not exceed 30 percent of your monthly net income (that is, your take-home income after taxes). Although 25 percent is preferred, 30 percent is acceptable. Further, when purchasing a home, a 20 percent down payment is recommended in order to get the best loan terms possible.

■ **Debt payments.** Your monthly payments toward paying down debt—including mortgage (or rent), car payment, student loans, or any unsecured debt, such as credit cards—should not exceed 40 percent of your monthly net income. This is your monthly "debt-to-income ratio."

■ **Cars and transportation.** Car payments, when totaled with other transportation expenses, such as gas, maintenance, licensing, and insurance, should not exceed 15 to 20 percent of your net income.

■ **A second mortgage.** A second mortgage or home equity loan should be considered only to make improvements that will increase the overall value of your home. After all, you are putting your home up for collateral so if you are taking that risk, use the money to do something that



enhances—rather than risks—your investment. As a rule, the payments on this type of loan (along with any payments on a first mortgage) should not exceed 30 percent of your income.

■ **"Borrowing" money from your 401K.** Borrowing from your 401K or other retirement savings should be an absolute last resort. Although this is a much better option than cashing in the account and taking the tax penalty, it's suggested you not do either. Your retirement funds are for your future, not for now.

Further, if you borrow from your retirement fund now, you'll have less money at retirement because you forego any potential investment gain of the borrowed money.

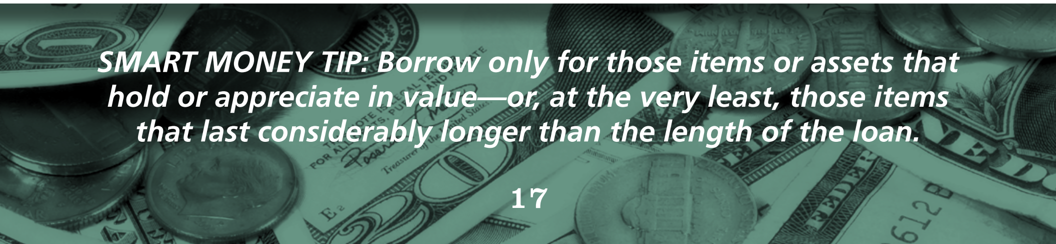
Also, if you cease working for your employer before a 401K loan is paid off, the loan is typically due in full within 60 days. If you're unable to pay back the loan in full within that short time, the money is then deemed an income distribution, which will result in a significant tax consequence.

■ **Payday loans.** Never borrow from payday loan companies, also known as payday advance companies. The fees on these are exorbitant and can create as many financial problems as the loan might temporarily solve.

■ **College loans**. Stay on top of overall amounts owed, interest rates, when repayment will start, and what monthly payments will be over what period of time. Also be aware of whether or not student loan repayment rates will be based on the student income after graduation.

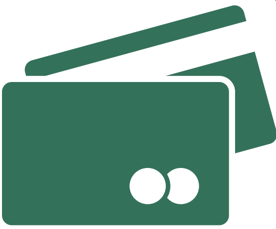
WARNING SIGNS OF A SERIOUS DEBT PROBLEM

- Paying required monthly payments to creditors and cards (not including mortgage or rent) totals 20 percent or more of take-home income
- Using savings or credit cards for daily expenses, such as groceries
- Using cash advances from credit card issuers to pay other creditors and/or daily expenses
- Paying the minimum amount (or less) due each month on your credit card bills
- Not knowing how much you owe
- Receiving calls or letters from creditors for overdue payments
- Fighting with a spouse or others due to money problems
- Experiencing a repossession, garnishment of wages, or a creditor's lawsuit



SMART MONEY TIP: Borrow only for those items or assets that hold or appreciate in value—or, at the very least, those items that last considerably longer than the length of the loan.

How To Use CREDIT CARDS Wisely



There is an assumption that anyone who uses credit cards must be carrying debt—and possibly lots of it. That doesn't have to be the case.

If managed and used with caution, credit cards can be a useful money management tool. But don't get me wrong: a credit card is not an absolute necessity and is not for everyone, especially for those who have difficulty saving and managing money.

Even considering the benefits of having a credit card, for some, it may be best to avoid using credit cards all together. Or they should at least limit their usage to very minimal amounts.

Rules To Use And Not Abuse Credit Cards

- When you use a credit card, know specifically when you plan to have that debt paid off. Don't use your credit cards again until your balances are paid in full.
- Think of a credit card as a tool to make some purchases more convenient, such as those bought online. Do *not* use a card as a substitute for money you don't have.
- Using a credit card wisely is a sound way to build good credit. Just don't carry a balance. You know the drill: Charge a very small amount in January; pay the balance in full in February; repeat.
- Reward points can be great for cash, gift cards, or products. But do *not* use a credit card to chase reward points with money you don't have.
- Transfer high-interest card debt to lower-interest cards in order to get out of debt more quickly and with less interest *only* if opening another credit card line does not encourage you to spend more.

SMART MONEY TIP: It's not really necessary to have more than one credit card, two at most. More credit cards encourages more spending and more debt.

How To Dig Out From Credit Card Debt

■ If you currently have credit card debt, I'd strongly suggest ceasing card usage completely until you're credit card debt-free. In fact, it may be good to destroy your cards altogether.

■ Build savings. You might ask "Why would I save any money at all when I'm trying to pay off high-interest debt and I would earn very little interest from my savings?" The answer is simple: Without money in a savings account for emergencies or shortfalls, the dependence on credit cards will continue. You'll stay in the credit card spin cycle.

■ Don't use a home equity loan to pay off credit card debt. Borrowing against your home can put your home at risk. Also, it can turn short-term debt into long-term debt, which can add hundreds to thousands of dollars of extra interest.

■ Never use debt settlement companies to reduce or payoff credit card or other debt. They take monthly payments from you but don't pay down your card immediately. This leaves you vulnerable to serious credit damage and perhaps legal action. Debt settlement staff usually work on commission and are highly profit-driven.

■ To pay off multiple credit cards, start with the card with the smallest balance and the highest interest rate. When this card is paid in full, roll the funds over to the next-smallest balance card.

Meanwhile, be sure to pay at least the minimum payments on all the cards on time. Determine a set amount to pay on credit cards each month and divide that among your various cards.

■ If you are overwhelmed with debt, seek advice from an accredited nonprofit credit counseling agency in your area.

THE COST OF CREDIT

Anytime you consider buying on credit, calculate not only the purchase price, but also the added cost of interest.

Let's say you purchase a $1,000 laptop computer on credit at 24 percent interest. You can afford to pay $25 per month. At that rate of repayment, it will take 6½ years to pay off the computer, which is likely to become obsolete before it's even paid off. Further, over that time, you'll have paid an additional $950, putting the true cost of the computer at just under $2,000.

CREDIT
Reports And Monitoring

Credit scores are key to everything from getting the best terms on a credit card to keeping your house payments low. So it's important that you know and understand your credit score.

WHAT ARE GOOD AND BAD CREDIT SCORES?

850-760	Excellent
760-680	Good
680-600	Fair
600 and below	Poor

Credit reports and scores are key to having a healthy financial life. Lenders such as banks, credit unions, and credit card companies all use a credit score to determine who qualifies for a loan and at what interest rate. Insurance companies and cell phone companies also use your credit to determine if they offer your their services or product. And even some employers when hiring will check your credit score.

What Is A Credit Score?

A credit score is a number based on a statistical analysis of an individual's credit profile from three credit reporting agencies. They do this to measure the creditworthiness of a borrower.

The most widely used scoring model is the Fair Isaac Corporation (FICO) score. The scoring range of FICO is 300 to 850. The higher end of the scoring range, shows more favorable credit. The average credit score is around 675.

SMART MONEY TIP: Lenders like seeing that you've had two types of credit: installment loans, such as a car loan, and rotating credit, such as a credit card—used responsibly.

CREDIT

HOW A CREDIT SCORE IS CALCULATED

Our credit scores are largely influenced by five main factors.

1. **Payment History**
   Approximately 35 percent of your credit score is determined by this factor. Simply put, if you pay on time, you'll have a better credit score.

2. **Utilization Ratio**
   Credit scores take into account how much debt we owe versus how much credit we have available. This counts for approximately 30 percent of your credit score. Maxed out credit cards will harm your score, but low balances on high credit limits will help. For example, if you have a credit card with a $1,000 credit limit, keeping the balance below 30 percent ($300) at all times will help your credit score.

3. **Length of Credit Account**
   This accounts for 15 percent of your score. The longer you've had an account open, the better.

4. **Inquiries**
   This accounts for 10 percent of your score. When you apply for credit, the lender will pull your credit report to determine your credit worthiness. This is considered a "hard inquiry" and will have some negative affect, however minor, on your credit score. When you pull your own credit report, however, it is considered a "soft inquiry" and does *not* harm your credit score.

5. **Types of Credit**
   This accounts for 10 percent of your score. Diversity counts when we're talking about installment loans and credit cards. You'll have a better credit rating if you have both an "installment loan" (such as a mortgage or a car payment) as well as "rotating credit," such as a credit card. This demonstrates you can manage both types of payments.

How To Get A Truly Free Credit Report

Knowing your credit score and the contents of your credit report is important. You'll want to check your credit report at least a couple of months before applying for a loan so that you can correct any errors beforehand.

It's also good to check your credit report every 12 months to spot signs of identity theft or any errors. In fact, a Federal Trade Commission (FTC) study shows that approximately one out of five credit reports have at least one error that should be corrected.

There are a number of sites online that say they will offer you a free credit report, but then after you log in, you find out that they want to charge you a fee.

But the law is on your side. The Fair & Accurate Credit Transactions Act of 2003 allows all consumers to obtain a free copy of their credit report once every 12 months from each of the three major credit reporting agencies: Equifax, TransUnion, and Experian.

The only web site to access truly free credit reports with no strings attached is *www.annualcreditreport.com.* If you're unable to access the reports through this site, you can order via phone by calling 877-322-8228.

WHAT TO DO IF YOUR BANK TURNS YOU DOWN FOR A LOAN

If a lender denies your loan request because of what you think might be a credit report error, you are unable to dispute it through the bank or credit union.

In fact, lenders aren't even allowed to provide you with the credit report.

Instead, the remedy is to get your personal credit report in order to find out more. Go to the website *www.annualcreditrport.com* and follow the steps on the page to the right.

If you get the error fixed, then go back to your lender and reapply for the loan.

SMART MONEY TIP: Don't waste your time—or money—using so-called free credit report services. The only truly free report is at a government site: www.annualcreditreport.com.

HOW TO DISPUTE AN ERROR ON YOUR CREDIT REPORT

If you find an error on your credit report, follow these steps to dispute and possibly correct it.

1. Go to *www.annualcreditreport.com.* Find the error or collection item in error on your credit report and highlight the name of the collection agency and account number.

2. All three credit reporting agencies (Equifax, TransUnion, and Experian) have a website or telephone number specifically for disputing errors. Visit the website or call the number. Whichever route you take, follow the prompts. They will ask you a few questions to determine what you are disputing and why.

3. Next, you just have to wait. The Fair Credit Reporting Act (FCRA) requires that once the credit reporting agencies (CRAs) receive your dispute notification, they are required to contact the creditor or collection agency in dispute immediately. The creditor or collection agency in dispute then has 30 days to respond to the credit reporting agencies with a correction or validation. If the creditor does not respond to the CRAs by the 30-day deadline, the information has to be deleted entirely.

4. You should expect to be notified by the three credit reporting agencies about 45 days from the date of initiating the dispute. You'll receive the results by email or postal mail.

5. The good news is that a Federal Trade Commission study found that four out of five consumers who disputed errors on their credit reports received some modification. So going through the dispute process is certainly a worthwhile step.

   If the dispute process doesn't get you the results you want, contact the creditor or collection agency and work to resolve the error with them directly.

Financial
TERMS TO KNOW

Accrued interest: The amount of interest that has built up since the date a loan was taken out.

Amortization: The paying off of debt in regular installments over a period of time. Also the deduction of capital expenses over a specific period of time.

Annual Percentage Rate (APR): How much interest you will pay over the course of a year. So if you have an annual interest rate of 10 percent APR on $1,500, you'll pay $150 of interest for the first year.

Compound interest: Interest paid not only on the initial amount of money but also on any interest accumulated from one period to the next, such as day-to-day or month-to-month.

Credit counseling agency: An organization offering free budget and credit counseling and financial education. Most good credit counseling agencies are non-profit and their focus is giving you the best, most responsible financial advice to meet your needs.

Credit limit: The maximum amount of money you can borrow under a revolving credit agreement, such as a credit card. Most credit issuers charge additional fees or penalties if you exceed your credit limit.

Credit rating: An assessment of the likelihood of an individual or business meeting its financial obligations. Credit ratings are provided by credit or rating agencies to verify the financial strength of the issuer for investors.

Delinquent: Accounts classified into categories according to the time past due. Common classifications are 30, 60, 90 and 120 days past due. Special classifications also include charge-off, repossession, transferred, etc.

Equity: The difference between an asset's current market value (the amount it could be sold for) and any debt or claim against it. So if you own a home valued at $200,000 but owe $150,000 on your mortgage, your equity equals $50,000.

Finance charge: A fee charged to you for receiving credit or extending credit. It may be a flat fee or a percentage of the amount borrowed.

Fixed rate: An annual percentage rate that does not change.

Grace period: The time period you have to pay a bill in full and avoid interest charges.

Unsecured credit: Credit for which no collateral has been pledged. Loans made under this arrangement are sometimes called signature loans; in other words, a loan is granted based only on the customer's words, through signing an agreement that the loan amount will be paid.

HOW MUCH HAVE YOU LEARNED FROM THIS BOOK?

Now that you've read this book, test yourself to see what you've learned.

1. The one website to access free credit reports with no strings attached is
A) *www.freecreditreport.com*
B) *www.freecreditscore.com*
C) *www.annualcreditreport.com*

2. Saving money requires
A) a sound budget that lists what you need to save for
B) very little discipline
C) knowing what you have left over after paying your bills and spending money

3. Credit scores
A) measure our creditworthiness
B) are used by employers, lenders, and insurance companies
C) both A and B

4. A good credit score
A) can save you thousands of dollars in your lifetime
B) is in the range of 680-760
C) both A and B

5. An acceptable reason to borrow money is
A) the item borrowed for holds or increases in value
B) the item borrowed for lasts several years after the loan is paid
C) both A and B

6. The 3 major credit reporting agencies are
A) Transunion, Experian, and TRW
B) Experian, Transunion, and Equifax
C) Equifax, Experian, and CSC

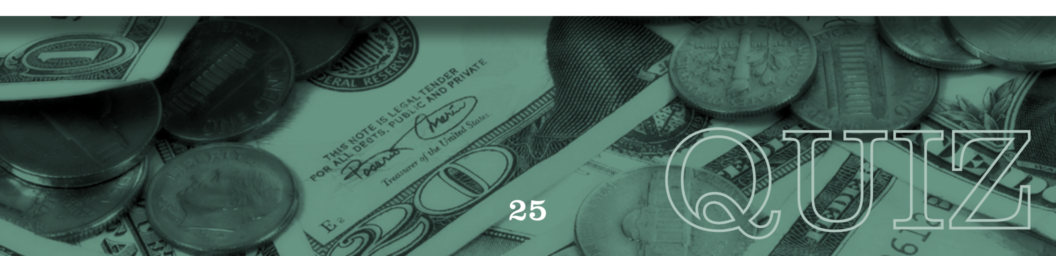
7. A good rule to apply to credit cards is
A) not have more than two
B) pay off your balance in full within the 30-day grace period
C) both A and B

8. If you find an error on your credit report, it's best to
A) contact the creditor reporting the information to the credit report agencies
B) dispute the information directly with the credit reporting agencies
C) Notify the Federal Trade Commission

9. When buying a car, it's better to
A) have at least 25 percent as a down payment if borrowing
B) Borrow from your 401K
C) Both A and B

10. If you have a bad credit score, you can
A) fix it quickly
B) take steps to increase it over time
C) take steps to lower it over time

ANSWERS: 1. C, 2. A, 3. C, 4. C, 5. C, 6. B, 7. C, 8. B, 9. A, 10. B



The Pay, Save, Spend Rule

A Simple Guide For Your Financial Health And Peace Of Mind

Being able to live happily within your means is achievable!

In this book, you'll find a sound method for wrapping your brain around all the bills, expenses, emergencies, cash shortfalls (and windfalls) in your budget—especially if you've been struggling financially.

Kent Johnson, a consumer credit counselor for more than 20 years and co-director of Consumer Credit of Minnesota, has worked with hundreds of people needing assistance to get out of debt, cope with a limited budget, and regain control of their finances.

Using the **The Pay, Save, Spend Rule**, Johnson breaks it all down into three achievable parts: ***Pay*** what you owe; ***Save*** what you need and want; then ***Spend*** the rest on items over which you have more control.

Inside this book, you'll find useful information on a variety of topics:

- Simple quizzes that help you understand what you know—and what you don't know—about personal finance
- A budget worksheet with tips for budgeting in a way that works for *you*
- Tips for reducing debt
- Realistic information to use and not abuse credit cards
- How to find your credit score and how to correct errors
- An explanation of how savings is a necessity—not a luxury—complete with ideas and plans to build savings
- Avoiding common credit and spending mistakes

There's an old saying that knowledge is power. This book will equip you with that knowledge to help you gain the power to cover your bills, give you savings for peace of mind, and spend your money on the things that you truly want and need for a satisfying life—guilt-free!

Published by Consumer Credit of Minnesota, 2013

Consumer Credit of Minnesota is a non-profit credit counseling service dedicated to helping people regain control of their personal finances. Through free, confidential credit counseling sessions and low-cost debt consolidation programs, it has helped thousands of individuals become debt-free.

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