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Financial Planning Tools for a UNI Graduate

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Introduction

The "American Dream" is on the minds of many college graduates across the country. Recent graduates desire to have a large house, nice vehicles, two or three children, the latest in gadgets, and financial security. However, achieving the American Dream most often leads to debt. Some individuals get bogged down by debt issues leading to a miserable life. Although they have material wealth, debt interest and payments consume every paycheck brought home. Many of these financial problems are due to the lack of financial knowledge and training.

This project will research financial planning tools for a new University of Northern Iowa (UNI) graduate. The following two research questions will be considered. First, what should graduates know about budgeting, investing, insurance, and spending? Second, what are the tax considerations related to these financial matters? The research for the project will be completed through reading articles and books from the library and recent online sources. Financial planning is important for UNI graduates because all of them will need to make many decisions related to finances over their lifetime. In the article Grads in Dark Over Finances, a poll of graduating seniors was sited. The poll found that nearly half of college seniors feel "not very" or "not at all" knowledgeable about investing and financial planning and only eight percent categorized themselves as "very knowledgeable" (Mseka, 2001, p. 36).

This project will provide readers with suggestions and tips on what to look for and how to handle different financial and tax issues. Topics covered include budgeting, investing (different types of investment and retirement planning), insuring needs (home, auto, life, health), and spending (homes, automobiles, and family). Taxes play a large role in all of these. This project will also look at ways to plan for tax savings.

Background

An individual's financial strategy should change as they get older to reflect financial planning goals. When an individual is young, they still have a greater amount of time to invest so they can be more aggressive with their financial planning. As an individual nears retirement, they cannot afford to be aggressive and risk large amounts of money. For UNI graduates, it is critical to start financial planning early. The following lists some critical considerations at ages 21-40.

Age 21-30

Establishing a good credit score is important in this stage of life. College debt needs to be paid down to free up money for investing and other financial needs. Money should be saved for a down payment on a home. Life insurance should be bought along with medical coverage for the family (Eisinberg, 2005, p. 21). Money grows over time. If anyone knows anything about compounding interest, they will know that money will grow slowly at first, but over time will begin to double and triple. That is why in this age range, it is helpful to be able to set aside a large portion of money to save for the future. Dayley says, "It is important to start identifying short-and long term goals and learn how to budget to make these goals happen" (Dayley, 2005, p. 56).

Age 31-40

When an individual reaches this stage, they should continue to invest in their retirement funds. It is important for an individual to periodically review their life insurance policy to make sure it is adequate for their current financial situation (Dayley, 2005, p. 56). It is also important for an individual to review their home owner's insurance policy to make sure it covers the rising costs of fixing their home in the case of an accident. Given the importance of financial planning, the following discussion will examine the tools (budget, investment, insurance, and spending) necessary for a college graduate to get started on his or her financial journey.

Budget

Merriam Webster defines a budget as "a plan for the coordination of resources and expenditures." The idea is pretty simple if an individual spends more resources than they have, then they will go into debt. If an individual spends fewer resources than they have, then they have a surplus. Finally, if an individual spends the same amount as the resources they have, then they have a balanced budget. According to Kapoor, "A budget is designed to help an individual live within their resources, spend their money wisely, reach financial goals, prepare for financial emergencies, and develop wise financial management habits" (Kapoor, Dlabay, and Hughes, 2001, p. 85).

Preparing a budget takes time, but it is rewarding to know one is using their money wisely. Without a budget, there is no tracking or planning of how funds should be and are being spent. Many readers will find themselves making many $2-$5 dollar purchases with their credit or debit card, and not keeping track of every expenditure. These $2-$5 dollar purchases add up quickly and many readers will find that they have spent more money than they have (i.e. deficit). The problem most students find themselves in is overspending month after month compiling a large debt.

There are five main steps in creating a budget. The first step is to set financial goals. These financial goals are what one desires to do in the future. The goals can range from short term, of going on a vacation this summer, buying a car in two months, or longer term goals of buying a house or a larger house, and providing for retirement income. A table from the text book Personal Finance provides examples of common financial goals.

Common Financial Goals

Personal Situation	Short-Term Goals (less than 2 years)	Intermediate Goals (2-5 years)	Long-Term Goals (over 5 years)
Single person	*Complete college *Pay off auto loan	*Take a vacation to Europe *Pay off education loan *Return to school for graduate degree	*Buy a vacation home in the mountains *Provide for retirement income
Married couple (no children)	*Take an annual vacation *Buy a new car	*Remodel home *Build a stock portfolio	*Buy a retirement home *Provide for retirement income
Parent (young children)	*Increase life insurance *Increase savings	*Increase investment *Buy a new car	*Accumulate a college fund for children *Move to a larger home

(Kapoor et al, 2001, p. 83)

The budget should then be designed to help an individual meet their goals and live within their income.

The second step will be to estimate the expected income that will be available during the budgeting period. Most individuals will have a specific budget for each month and a broader budget for the year. Taxes should be considered when estimating available income. If an individual makes $20 an hour and works 40 hours a week, they will not actually bring home $800. Taxes will be taken out of the paycheck. When preparing the budget, do not use the $800 figure as available income. If the income earned is not easily determined, it is better to estimate lower than what is expected to be received than higher. It is better to get to the end of the month and find one still has funds available then to realize one spent too much.

The third step involves allocating the funds available for the month. This number was calculated in step two. First, one needs to determine what expenses are the same every month? These are fixed expenses and will not change month to month. These could include rent or mortgage payments, utilities, phone bill, loan payments, insurance premiums, etc. Once the fixed expense number is calculated, the number should be recorded on a piece of paper under the income number. The second step will be to calculate those expenses that vary in amount from month to month. Items in this category include food, clothing, transportation, cleaning supplies, etc. It will be better to estimate higher than lower. This estimation can be based off of what was spent last month and any spending changes for the current month. These are called variable expenses and will be the third item on the budget. The next item in this category is a savings/emergency fund. It is recommended that a portion of the income earned each month be set aside for savings. It is also recommended to build up an emergency fund. The recommended size of the fund is three to six months of living expenses (Kapoor et al, 2001, p. 83). The living expenses include both fixed and variable expenses. The budget can be as general or as detailed as you would like. Some individuals prefer to bunch items together in groups with titles like entertainment or recreation. Others prefer to label each category in detail such as eating out, movies, baseball game, etc. The last step in this section will be dividing out the remainder of the income to obtain the goals developed in step one. If one desires to go on a vacation at the end of the summer, a larger percentage of the remaining funds may go towards savings for a vacation.

The fourth step is to keep track of everything spent and received during the month. This process is not the most exciting activity an individual can do throughout the month, but is necessary if one wants to manage their funds wisely. As an individual records how their funds were spent throughout the month, keep track of the differences between what was budgeted for the month and what was actually spent for the month.

The fifth and final step is to evaluate the budget at the end of the month. Are there areas that were overspent? Are there changes that need to be made? Budgeting is an ongoing process and an individual cannot expect the same budget to work every month. When the reflecting process has been completed, it is time to start over again with step one and make changes for the next month.

Kapoor provides characteristics of a successful budget:

Well planned. A good budget takes time and effort to prepare. Planning a budget should involve everyone affected by it. Children can learn important money management lessons by helping to develop and use the family budget.

Realistic. If one has a moderate income, do not immediately expect to save enough money for an expensive car or a lavish vacation. A budget is designed not to prevent one from enjoying life but to help one achieve what they want most.

Flexible. Unexpected expenses and changes in cost of living will require a budget that can be easily revised. Also, special situations, such as two-income families or the arrival of a baby, may require an increase in certain types of expenses.

Clearly communicated. Unless an individual and those involved are aware of the spending plan, it will not work. The budget should be written and available to all household members (Kapoor et al, 2001, p. 87).

Investment

Everyone at one point or another has heard the wise words from Benjamin Franklin, "A penny saved is a penny earned." The quickest way to meet financial goals is through savings. Saving and investing one's income allows one's money to grow and also provides a buffer against any emergencies that come along.

Basic savings accounts are a great place to start when trying to put aside some money. The rate of return (technical term for interest rate) are low so this is not a "grow your money fast" solution, but there is no risk so one can sleep well at night knowing their money is safe. Another low risk investment is certificate of deposits. Certificates of deposit carry a higher rate of return than savings accounts. The downfall is there are significant penalties for withdrawing one's money early, and an individual's money is locked up during the duration of the certificate of deposit. The interest rate on a certificate of deposit is greater the longer one holds the certificate. It is recommended that one stagger the maturity dates of the certificate of deposits so that there is a certificate of deposit maturing every 90 days (Young, 2006, p. 94). That way one is ensured of having funds available in case of an emergency and does not have to worry about early withdrawal penalties.

In the article Generation X strikes back, experts advise college graduates to build an emergency fund of three to six months' living expenses. They say the first \$2,000 should go into a low-risk money-market fund and the rest in a short-term bond fund (Fenner, 1994, p. 5). The emergency fund is there to protect against any sudden emergencies or unplanned expenses. Lankford writes, "The idea is to keep enough cash on hand so that you don't have to sell stocks or rack up expensive credit-card debt if you have an emergency—but not so much that you lose out on the higher returns you can earn on longer-term investments. Emergency money needs to be safe and accessible" (Lankford, 2005, p. 82).

Other investment opportunities including the stock market, mutual funds, and exchange-traded funds, contain a higher risk and are why these opportunities produce a higher rate of return. If one looks at what has happened in history, it is best when investing in these markets to split one's funds between the different sectors of the market. Having all of one's funds in one stock or mutual fund can be financially devastating. Just ask the many employees of Enron whose stock dropped to zero after the scandal and contained their entire retirement savings. Those employees lost all of their savings due to lack of diversification in their portfolios. Diversification in investing encourages one to split their money up among the different markets (i.e. technology, pharmaceuticals, consumer goods, housing market, foreign markets, etc).

Retirement

Planning for retirement is one of the primary investment decisions. It is safe to say those readers currently in college should not expect to be able to live off of social security when they retire. For this reason, it is important to start planning for future retirement immediately upon starting one's first job. Many jobs have 401(k) plans (named after Internal Revenue Code section 401) and will match the amount of contributions (up to a limit) that one sets aside in the plan. Take advantage of these and set aside as much as one can. The budget prepared earlier will determine the amount to contribute each month. These retirement funds will grow tax free (saving you money) until withdrawals are made upon retirement. At that time, the funds will be taxed but may possibly be taxed at a much lower rate than if one was taxed on the income before retirement. There are also Roth and traditional IRAs (individual retirement accounts) that are often recommended as retirement savings vehicles.

> In the article Rating the Rules of Thumb, Lankford writes, "Roth IRA, with its promise of tax-free withdrawals in retirement, is the better choice over a traditional IRA. However, the opportunity to use a Roth is phased out as adjusted gross income rises between $95,000 and $110,000 on a single return and between $150,000 and $160,000 on a joint return. If your income is too high for a Roth—and you're not covered by a retirement plan at work—fund a traditional IRA and deduct your contribution on your tax return" (Lankford, 2005, p. 83).

Retirement is a reward for the years of service to an employer. Retirement should be relaxing and enjoyable. Reaching retirement with insufficient funds to support the chosen lifestyle will cause more headaches and will not be relaxing and enjoyable. Start planning today so that you are not part of the statistic Breitbard mentions, "More than half of American workers between the ages of 45 and 54 did not have any kind of retirement account in 1998" (Breitbard, 2003, p. 56).

Insurance

So far the topics of budgeting and investing have been discussed. In this section the focus will be on how to protect oneself, one's family, and the assets owned. There are four main categories of insurance--life, health, home, and auto. The following provides a more detailed description of each type of insurance.

Life Insurance

Life insurance provides financial help to your family when you die. When purchasing life insurance, it is important to shop around to get the best price. CNN Money says that there are many companies out there ready to sell insurance because of the high-commission they can get (CNN Money-Life Insurance, 2007). Though it is important to have insurance, it is equally important that it covers one's assets, their family, and themselves. Robert Bland, chief executive officer of Insure.com says, "Your life-insurance coverage should equal eight to 12 times your annual income." Lankford adds, "To get a more precise number, add up your family's expenses, then subtract sources of income available after your death—and buy enough life insurance to make up the difference. Don't neglect the value of a stay-at-home spouse, expenses for child care, and other services that could increase significantly" (Lankford, 2005, p. 83).

There are four main types of life insurance: term, whole, variable, and universal. There is always a debate over whether one should purchase term or whole life insurance. Applegarth in <u>The raging debate over term vs. whole life</u> sets out the facts of the two to help distinguish between the two types of policies. Applegarth writes,

> Term life policies offer death benefits only, so if you die you win (so to speak). If you live, you (or more specifically, your family) get no money back. Whole life policies offer death benefits and a "savings account" (also called "cash value" or sometimes, "account value") so that if you live, you usually get at least some of, and often much more than, the amount you spent on your premiums. You get this money back either by cashing in the policy or by borrowing against it (Applegarth, 2007).

It is important to keep in mind when purchasing life insurance if an individual is buying as a way to invest buying whole life probably is not the best place. An individual can invest in other markets which will return a higher rate. At the same time, if an individual is looking for long-term coverage then whole-life may be the best. Applegarth writes the key to choosing between term and whole life is how long one plans to keep the policy. If the answer is less than ten years, term is clearly the answer. If it is more than twenty years, whole life is probably the way to go (Applegarth, 2007). An individual can get an expert to run an analysis between the two, and this paper recommends having an analysis completed before you decide. The definitions of universal life and variable life are defined and summarized below:

> Universal life insurance is more flexible than traditional whole life because the premiums can vary from year to year and sometimes the premiums can even be skipped. Universal life has maximum guaranteed premiums and a least minimum guaranteed cash values and death benefits. Variable life insurance has the fewest number of guarantees and therefore the greatest potential for cash value increases. There are required guaranteed annual premiums and a guaranteed minimum death benefit. However, there is no guaranteed cash value and you have to select the investment for your policy (Applegarth, 2007).

All in all, the life insurance decision comes down to this simple rule of thumb, "buy term and invest the rest." However, if an individual is not comfortable with managing their investments or will spend available money instead of investing, purchasing whole life as an investment opportunity is the correct decision.

Health Insurance

As noted in the introduction to the section on insurance, health insurance protects the purchaser from the risks of medical costs. Medical costs spring up fast and are very expensive. For this reason, health insurance is necessary to avoid large medical bills that will devastate one's financial position. In an article titled Insurance data may build pressure for overhaul of health care system, Smith reports, "A U.S. Census Bureau report found that 46.6 million Americans--almost 16 percent--had no health insurance in 2005, representing an increase of 1.3 million over the previous year" (Smith, 2006, p. 1267). This means 46.6 million Americans are in big trouble if a medical emergency ever arises and they do not have enough money saved up to cover the costs. In the article Healthy Planning, Coolidge writes, "Going without insurance is not an option. Last year more than half of all personal bankruptcies in the U.S. were prompted by medical problems, according to a joint study conducted by professors at Ohio University and Harvard" (Coolidge, 2005, p. 162).

Coolidge offers a number of suggestions to obtain medical insurance coverage and then maintain coverage throughout your life. She writes, "Individuals trying to buy insurance on their own confront a difficult marketplace whose providers don't particularly want their business, especially if they have a preexisting medical problem" (Coolidge, 2005, p. 162). Most employers offer a group health care package. Group health is generally less expensive than purchasing the same coverage on one's own. Ernst & Young talks about three different types of health service providers. The first are "Fee-for-service policies" that allow the greatest flexibility in choosing health care providers. An individual receives treatment from the doctors they want to use and the insurance company pays some or all of the medical bills (Garner, 1999, p. 175).

The second type is a "Health Maintenance Organization (HMO)." With an HMO, the insured joins the organization, pays a monthly fee, and receives medical care, all under the umbrella of a single provider. The advantages of an HMO are lower monthly payments, less paperwork, and potentially "one stop shopping." The disadvantage of HMOs is limited choice because the insured must use the physicians and medical providers chosen by the HMO (Garner, 1999, p. 178). If an individual has a preexisting medical condition, they may find it difficult or expensive to purchase a fee-for-service policy. In this case, after checking to see if the condition is covered by the HMO, joining the HMO will pay off economically (Garner, 1999, p. 179).

The third type of medical service provider is a Preferred Provider Organization (PPO). The PPO attempts to provide the best of both the Fee-for-service policies and the HMO. Here an individual joins a PPO and as long as they use their list of health care providers, they will receive coverage at a reduced rate. An individual can (like the Fee-for-service policies) go to any provider you choose. The difference is if doctors are not on the list, then they will still be covered by the PPO but not at the reduced rate (Garner, 1999, p. 179-180).

If an individual was on their employer's health coverage and suddenly finds themselves without a job, there is no need to panic right away. The Congressional Omnibus Budget Reconciliation Act known as COBRA allows one to continue to participate in their employers' group health benefits plan, at their own expense, for eighteen months (Coolidge, 2005, p. 162). COBRA will protect a purchaser while they search for a new plan. Searching for a new plan should be done very quickly or ahead of time if one knows they will be without a job. Paul Zane Pilzer, author of *The New Health Insurance Solution* says, “Choose this (COBRA) as a very last resort, it is expensive and it is temporary. If one develops a health condition while on it, they could be prevented from getting permanent affordable health insurance” (Coolidge, 2005, p. 162).

As one can tell, health insurance is not an option. One does not want to end up uninsured facing high medical expenses and find oneself leaning towards bankruptcy. Plan ahead while healthy and purchase an individual health insurance policy.

Home Insurance

Purchasing a home is one of the biggest purchasing decisions an individual will make in their lifetime. The next section on spending will talk in more detail about purchasing a home. Homes are not cheap so an individual will want to protect the home against any potential lawsuits, theft, or damage. Kapoor writes, “Studies reveal that as many as two-thirds of homes in the United States are not insured or are underinsured. Financial losses caused by fire, theft, wind, and other risks amounts to billions of dollars each year” (Kapoor et al, 2001, p. 323).

A homeowner’s insurance policy will protect one’s home and the belongings in the home and on the property against various risks (theft and weather related), and liability. A homeowner’s policy generally protects against four different types of financial risks. These areas are buildings and other structures, additional living expenses, personal property, and personal liability and related coverage.

Building and other structures includes one’s home, garage, and any other structure on the property like a shed, fence, playground, etc. This section also protects against damage to trees and shrubs and any plants on one's property. The next section covered by the policy is additional living expenses. This section will save an individual money if anything happens to their home, making it unlivable for a period of time. For example, imagine one of the trees in the lawn falls on the house during a storm, putting a big hole in the roof and collapsing part of the exterior walls. The buildings and other structures section will provide funds to rebuild the house, and the additional living expenses section will cover the costs for an individual and their family to stay at a hotel until the wall and roof are fixed and one can move back into their home.

The third section of a homeowner's policy is personal property. This section protects the belongings one owns within the home. In order for the items to be covered, one needs to be able to prove they own the items and the value of the items. One of the best ways to do this is to use a video camera to record what the house and property look like. Keep this tape in a fireproof safe or bank deposit box. Kapoor also notes, "For items of special value, you should have receipts, serial numbers, brand names, model numbers, and written appraisals of value" (Kapoor et al, 2001, p. 319). The inventory can also include photographs. Record the date the photograph was taken and the value of the item on that date. Regularly update the inventory to keep track of changes in value and to include new items purchased.

The final home insurance section is personal liability. Everyone lives in a world of unpredictability. No one can predict the future and one never knows when something unexpected might happen. The liability section will protect one from financial loss due to the injury or damage of another person's property for which an individual is responsible for. This coverage will also include the costs of legal defenses.

The homeowner's insurance policy that has been discussed is what an individual typically will come in contact with. If the individual purchasing the insurance lives in an area known for floods and earthquakes, they will need to purchase separate policies that will protect against those hazards.

If an individual does not own a house there is still a need to purchase insurance. The insurance, however, will look different. If an individual is renting a home or an apartment, there is renter's insurance. The main component of this policy is protection from financial loss due to theft or damage of personal property. The benefit is renter's insurance is less expensive than homeowner's insurance and will protect against many of the same risks discussed above.

It is very important to look over the insurance policy every year. If an accident does happen, one does not want to find out that the policy was not large enough to cover all of the expenses. Construction costs should be kept in mind when considering how much coverage is needed. Construction costs generally rise from year to year due to inflation. This means the cost to rebuild one's home in year one will be less than the cost to rebuild the home in year five. When looking for a policy, an individual will also need to decide between replacement value or depreciated value. If the insurance policy is for depreciated value, the insurance most likely will not cover the full repair bill because overtime, the value of items are less than what you originally paid for new items. So if faced with the decision of replacement vs. depreciated value, choose replacement so that the insurance will cover the bill to replace the damaged items at the current day value. If one's policy has a coinsurance clause, make sure you have coverage for the stated percentage. In most cases, the percentage is 80% of the value, which means if an individual does not have coverage of $80,000 on a $100,000 home, they will have to pay part of the losses (Clarkson, Miller, Jentz, Cross, 2006, p. 994).

Automobile Insurance

Another big purchase an individual will make is an automobile. The actual purchase of an automobile will be covered in the next section on spending. In this section, the discussion centers on how to protect one's car and everything else one owns through auto insurance. Kapoor writes, "Each year, motor vehicle crashes cost over $150 billion in lost wages and medical costs" (Kapoor et al, 2001, p. 326). There are two types of damages covered by auto insurance. The first is bodily injury liability and the second is property damage liability.

Bodily injury liability will cover medical costs for the insured or any other people involved in the accident. This is the section that will help pay for any court costs if the incident should escalate to court. An individual will generally see terms like 100/300/50. Each of those terms are in 1,000 dollar figures. The first number indicates there is $100,000 liability coverage for one individual. If the actual damages should exceed $100,000, you would be responsible for the rest. The second number informs one that one has $300,000 liability coverage for all other individuals involved in an accident. The third number will be talked about next with property damage (Clarkson et al, 2006, 1001).

As discussed above in the health insurance category, medical expenses can add up very quickly and can be financially burdensome. The auto insurance medical payment coverage will cover health care costs for any individuals injured in one's vehicle. Accidents happen, so it is always best to have insurance coverage in case an accident happens. However, not everyone has insurance. If one finds themselves in an accident caused by an individual without insurance, the uninsured motorist's protection will cover medical.

The second type of damage covered by auto insurance is property damage. The property damage coverage protects against financial loss if one were to damage someone else's property. Property damage represents the third number in the coverage terms of 100/300/50. This particular policy will cover up to $50,000 of property damage (Clarkson et al, 2006, p. 1001).

Collision insurance protects your vehicle if it is involved in the accident. Whether one is at fault or not in the accident, one's insurance company will pay for repairs. However, if one were not at fault one's insurance company will try to recover part of the damage costs from the other individual's insurance. The downside to being in a collision, Kapoor writes, is "The amount you can collect with collision insurance is limited to the retail value of the automobile at the time of the accident. If you have an automobile with many add-on features or one that is several years old and has been restored, you should obtain a document statement of its condition and value before an accident occurs" (Kapoor et al, 2001, p. 329-330).

Most auto insurance providers offer umbrella coverage that add to the policy. Umbrella coverage will cover any additional liability that the home owner's policy will not cover (Clarkson et al, 2006, p. 1001). As one obtains more and more assets and their financial net worth grows one will want to consider taking out as much insurance coverage as available. Many policies have add-on coverage where one can take a policy that will protect up to a million dollars. Being covered by insurance helps protect against financial loss in the case of a lawsuit based on an accident. Additional coverage may start to get more expensive but there is a chance the insurance company will offer reductions if you purchase other insurance from them also.

Spending

The final category that will be covered is spending. This is everyone's favorite topic, and the most important to think about. As one reads this final topic think about the area in terms of the three sections covered earlier, budgeting (is spending money here part of my goals and part of the budget?), investing (would it be wiser to invest the money now and gain interest on it or spend it on this purchase?), and insurance (how can I protect what I just bought?). For example when thinking about purchasing a house the following thoughts should come to mind: "Is purchasing a house one of the financial goals I have laid out for myself, and have I budgeted for the expenses that come along with purchasing a home? Are there funds set aside in savings for this purchase?" And finally, "Did I consider insurance?" It does not do any good to purchase a home, not cover the home with insurance, and have a fire completely destroy everything just purchased. This topic will cover four main areas of spending (consumer debt, automobiles, home, and charitable contributions) and the tax implications that go along with each one.

Consumer Debt

Credit cards have become a popular payment option among individuals worldwide. It is nearly impossible to go through college without coming in contact with a credit card, or a credit card offer. Breitbard writes, "College freshmen get an average of eight credit card offers their first week of school. University administrators report they lose more students to credit card debt than they lose to academic failure" (Breitbard, 2003, p. 56). Having a credit card causes many individuals to spend more money than they make. According to Jump-starting Financial Literacy, "40 percent of Americans live beyond their means, and average credit card debt per household rose to $8,562 in 2002 from $2,985 in 1990" (Breitbard, 2003, p. 56).

Credit cards are not entirely bad. One of the most important scores a recent college graduate should be aware of is their credit score. The credit score will dictate whether financial institutions will loan money and what interest rate will be made available. Using a credit card and making payments on time and at least at the minimum level will increase the credit score. Many credit card companies offer cards with rewards. Every purchase made with the card earns points towards receiving reward. A college graduate generally does not have a lot of money right out of school so why not get free money and other rewards? The important consideration to keep in mind is to pay off your credit card balance every month. Consider the following example of why this is important. Assume the credit card has a yearly interest rate of 18% (which is the rate most college students will receive) and has only been used to make one purchase of $4,000. The minimum payment for this account is $83.33 ($4,000 / 48). If an individual only makes the minimum payment each month, they will make the last payment on the account 29 years later, and their $4,000 purchase will end up costing them $13,000. Making the minimum monthly payment is not a wise use of one's money (Cap & Compass, 2006, p. 73).

Many individuals have half a dozen or more credit cards in their wallet, many of which they no longer use. The lingering question is what to do with the cards you no longer use. There are two solutions available for cutting down the number of credit cards in your possession. The first solution is to close down the accounts no longer in use and cut up the cards. The second solution is to leave the accounts open, but still cut up the cards. Here is how closing the accounts could hurt you:

> Closing old accounts lowers the amount of credit you have available, and that can be a black mark on your record. When lenders decide whether to extend credit, they look at how much of your available credit you're already using—poetically called your utilization ratio. Let's say you have five credit cards, each with a \$10,000 limit, and your total balance is \$6,000. That gives you a utilization ratio of 12%--not bad, in the eyes of lenders. But if you close four of those accounts, your ratio suddenly jumps to 60%--not good. Ideally, you should keep your utilization ratio below 50% (Lankford, 2005, p. 82).

It is important to maintain a high credit score to receive favorable interest rates from financial institutions. An individual's credit score will impact the purchase of an automobile and a house. Laws have been developed to protect credit card users. If you discover when you receive your credit card statement that there are purchases that you did not make, and that you cannot find your credit card, notify the company immediately. You will only be required to pay a maximum of \$50 on fraudulent purchases (Clarkson et al, 2006, p. 892).

To make wise use of one's money, it is a good thing to use a credit card for purchases if you have the money in the bank to pay off the balance each month. As explained earlier, just paying the minimum balance can end up costing you a lot more money for the item purchased. The benefits of using the credit card if you have enough money in the bank include an increase to the credit score (if payments are made on time), and the ability to store up rewards. It is recommended one finds a credit card with a low monthly interest rate and one that provides rewards. These rewards are free money back for making a purchase with the card. A disadvantage is the interest you pay on credit cards is not deductible on your tax return. Instead of using a credit card for large purchases, it may be best to take out a mortgage on one's home because the interest is deductible. Use credit cards wisely and stay within the budget created in section one.

Automobiles

Mobility is a key factor in most individual's lives. Due to weather conditions and desire to travel long distances, most individuals will have to make a decision about purchasing an automobile. The first decision you will have to make is if you want to buy or lease the vehicle. If you choose to buy, you will be faced with a second decision about purchasing a new or used vehicle. Whether you lease or buy you will be faced with the final decision of which vehicle to choose.

If you decide to buy consider what Kapoor writes, "The average used car costs about $10,000 less than the average new car. New cars cost an average of about 50 cents a mile to own and operate; used cars cost an average of about 35 cents a mile" (Kapoor et al, 2001, p. 262). If you decide to purchase a used vehicle make sure you have a trusted mechanic inspect the car before you make the purchase. You want to make sure the car you are purchasing is running well. As with any major purchase you make, it is best to do research ahead of time. Find out about the different safety features offered in vehicles, look up various vehicle models and compare quality and features, see what other people say about the different types of vehicles, and determine a price range you are willing to pay. Come prepared when making a purchase. Being prepared will protect oneself from being taken advantage of by the more knowledgeable sales representatives. Price is one of the main factors to consider in purchasing a car. The buyer wants to get the lowest price possible while the seller wants to sell higher to make a larger profit. When purchasing a car, price negotiation is allowed and is a common practice. The key to negotiating the best price is to do research. Look at other car advertisements to see what similar vehicles are selling for. Common sources for price information are *Kelley Blue Book* and *Edmund's New and Used Car Prices*. This information can be accessed on the internet, or is available at banks, credit unions, libraries and bookstores (Kapoor et al, 2001, p. 264).

When purchasing a new car, an individual needs to do the same homework one would do for a used car purchase. Read *Consumer Reports* to find out what others are saying about the different vehicles. In addition, determine what purposes the vehicle will serve. The next aspect will be determining what additional features you want the car to have. When you have found the car you want, you will need to negotiate a price. There are two figures you need to know: the first one is listed on the car, the second one you will have to look up in one of the pricing guides listed above. When you find what price the dealer was able to buy the car at and what price is on the car, it is your job then to offer a price you are willing to pay that is between those two prices. Be firm and be willing to walk away if the sales representative is not budging. There are other car dealerships. It is best if you come with a plan to finance the car, whether you are going to pay in cash, or already have a loan from a bank. This will help you determine the price you are able to pay.

If you decide to lease a vehicle instead of purchasing a new or used vehicle, there are both benefits and disadvantages to this decision. The benefits include making smaller monthly payments, not having to pay for many repair costs, and paying less up front. A disadvantage is not getting to choose the level of insurance coverage you have. This may end up costing you more than purchasing a car. Also, you have restrictions on how far you can drive the car each year and you do not own the vehicle at the end of the lease term. Lankford writes, "If you buy a new vehicle as soon as your old one is paid off, leasing can save you money. Buying is a better deal if you hang on to your old car" (Lankford, 2005, p. 83). Keep in mind when purchasing a car that particular vehicle models are more expensive to insure.

House

The second major purchase decision is a house. When purchasing a home the main consideration centers around your lifestyle. Do you like to move around a lot or do you like to call a single area home? The answer to this question will aid in your decision on whether to rent or buy. In either decision you will need to determine how much you can afford to spend on housing each month. The answer to that can be found in the budget you created. Bonnikson provides a rule of thumb to follow in a purchasing decision, "When purchasing a house a good rule of thumb is to make sure your monthly mortgage obligations--including principal, interest, taxes and hazard insurance--doesn't exceed 30% of your monthly gross income" (Lankford, 2005, p. 84). In the next couple of paragraphs some advantages and disadvantages for both renting and buying will be discussed.

Renting a home is less cumbersome then buying. There is very little upkeep and much of the repair work is performed by the landlord. There is a greater sense of mobility as you are not tied down to any one location. Additionally, the initial cost of renting is low. Often times you only have to make a deposit of one or two months rent, of which you get all of it back minus an application fee if you leave the home or apartment in good condition. However, not everything is great when renting. Renting restricts your lifestyle. The lease describes what you can and cannot do in the house and on the property. You may not be allowed to have pets, or smoke, or paint the room, and may be told to be quiet at night. You also are unable to take tax deductions for the rent payments you make. There are also a lot of legal details that are involved. The lease is one large legal document that you need to follow. That is why it is very important to read the entire lease and make sure you understand everything in the lease before you sign it.

Purchasing a home also has some advantages and disadvantages. The main advantage is you get to call this place your home. You can decorate and do what you want with the home, that is as long as you are still following the state and federal laws. You also get to enjoy the increases in property value which you can reap the benefit of when you decide to sell your home someday. Very few people pay for the home in cash. Instead a mortgage is taken out as a loan for the home. A benefit here is you get to deduct mortgage interest and any real estate tax you pay each month on your tax return. Some disadvantages to owning a home are the higher living costs. You are responsible for the upkeep and maintenance of your home and the initial cost of owning a home is much larger. Most lending institutions require a large down payment at the date of purchase.

Charitable Contributions

Contributions to charities should be carefully thought out. There are over a million causes you can donate your money to. In the article The Science of Smart Giving Hempel suggests focusing on the question, "How much impact am I going to have?" Think about what you value and then find a charity in that category who is the underdog. You know then that your contribution is making the biggest impact (Hempel, 2006, p. 96). Underdogs are those organizations who do not receive national attention. Your contribution will make the most impact on these smaller organizations. The IRS website provides tips to ensure your contributions pay off on your tax return. The main theme to remember is to make sure the organization is a qualified charity and to keep all (www.irs.gov, 2007). In the past individuals could claim they dropped $10 in the offering at church every Sunday. Starting in 2007 to deduct a contribution on one's tax return requires one to have a receipt or confirmation of the gift. It is important to plan ahead when giving to charities. Remembering on March 1st while preparing your tax return that you forgot to donate last year, is too late. There is a limit on how much you can deduct. You can deduct up to 50% of your adjusted gross income (www.irs.gov, 2007). It is also important to keep in mind that you can only deduct contributions if you itemize on your IRS Form 1040, Schedule A. It is not too late for you to make a difference in the world, so choose a worthy cause and begin donating today.

Conclusion

Throughout this paper, a new college graduate has learned a number of tools and has been given a number of tips in the areas of budgeting, investing, insurance, and spending. I hope each reader has picked up on the importance of each of these four areas.

In the budget section, remember to carefully plan out the budget and keep the budget flexible. Creating a budget will help you live within your means. In the investing section, remember that it is never too early to start planning for your retirement. Let your money work for you. Invest in diversified means and allow the power of compounding interest to work for you. On the topic of insurance, remember that going without insurance is not an option. Protect yourself and all of the assets you have worked so hard to purchase. As far as spending goes, spend wisely. Avoid impulse buying if at all possible. Shop around for the best deals and go into each buying decision with purpose of what you want and how much you are willing to spend. Also, remember that credit cards can either be your friend or your enemy; avoid making just the minimum payments. For each spending situation carefully consider the tax consequences that go with the decision and make the best use of your funds. Each of the items discussed throughout the paper are valid options to consider. Different financial situations call for different options. Take the knowledge and information learned in this paper and begin your quest to be financially responsible and make wise decisions regarding your money.

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