Money Management

Building a Good Credit Score

Quite a few years ago, a retailer in our town passed on to me a few tips on how to establish a good credit rating. The first tip is one that everyone already knows. <u>NEVER</u> miss a payment and <u>NEVER</u> be late with a payment. This means any payment: mortgage payment; vehicle payments; credit card payments; and utility bills etc. Paying on time is critically important. Paying early avoids the possibility that your payment could arrive late or be credited late. Additional credit to your score is also given by the credit bureaus for making more than the minimum payment. This can also apply to mortgage, credit card, and consumer debts, and will also reduce the total interest that you end up paying over the life of the debt.

Ideally, each of us will at some point reach a time when we can pay off all credit card debt each month. Most credit card issuers offer a grace period, meaning that if you pay the entire amount charged to your card that month you will not be charged any interest.

While credit bureaus appreciate monthly payments of the entire debt, card issuers have a different point of view. As long as people are making payments regularly, they like to see a balance so they can charge interest. Some issuers of "store" credit cards actually make more money on the interest from the credit cards they issue than from the sales in their stores. Think about it. When you check out, they ask if you will be using a card issued by that store. Some issuers will also have cards that can be used many other places. Again, they hope to make money charging interest on balances not paid in full.

Issuers have a new definition of “dead-beats.” It used to be someone who didn’t pay their bills. Now it also means someone who pays their bills in full each month and doesn’t acquire any interest charges.

Having too many charge cards (Open Accounts) can also be detrimental to your credit score. Credit cards can be handy tools to have if used properly.

Achieving a good credit score will make obtaining loans easier and may lead to lower interest rates on loans.

Building A Good Credit Score-Summary

Never Miss A Payment

Never Be late With A Payment

Make More Than The Minimum

Do Not Have Too Many Open Accounts

Mortgage & Installment Loans

Mortgage and installment loans are something that almost everyone has or will have at some point. They are normally set up for monthly payments, they may have a fixed rate of interest for the life of the loan, or they may be subject to changing rates after a certain period of time. There are relatively painless ways to shorten the time period for the payback and to lessen the amount of interest paid during the life of the loan.

For people who are paid bi-weekly, one easy way to reduce interest and get the loan paid off quicker is to make bi-weekly payments. For example, if you have a monthly payment of $400, making a $200 payment every two weeks will help in two ways. First, the interest will be reduced because you are reducing the principal every two weeks instead of once a month. Each reduction of principal reduces the amount of interest for the next payment. Secondly, if you faithfully make the payments every two weeks, you will be making 26 payments during the year. This is like making an extra monthly payment each year. It is a good idea to check with your financial institution to determine if they have prepayment penalties, although they would be unlikely.

Another way to reduce interest paid on a loan and shorten the repayment time is to pay more than the minimum amount due each month. When you make a payment, the amount due for interest is determined. Any amount over the interest payment is applied toward the principal. The amount toward the principal will never have more interest charges. If you pay extra, the entire extra amount is applied to principal reduction. This means you will never pay interest on that again. If you have a 20 or 30 year mortgage or a 3 or 4 year vehicle loan, you can save a lot of interest charges by paying extra with each payment. This will also reduce the time required to pay off the loan.

It should be everyone's goal to pay as little interest as possible and to pay off loans as quickly as possible.

Mortgage And Installment Loans-Summary

Make Payments On Time

Make Bi-Weekly Payments

Pay More Than The Minimum Amount

This graph represents a stack of 100,000 one dollar bills, the amount used to represent the mortgage for this example.

We are assuming a 30 year mortgage at the fixed rate of 4%,

This will require 360 payments of $477.42 if paid exactly as scheduled.

The first payment will apply $333.33 towards interest and $144.08 towards principal.

It would not be until payment 153 before the amount applied towards principal exceeds the monthly interest charge.

If paid exactly on schedule the total interest charge would be $71,869.51.

This graph represents the amount owed after the first payment. $99,855.92.

You will never have to pay interest again on the $144.08 that was applied to the principal after the first payment.

If you pay bi-weekly, you can save on by reducing the amount left on principal each two weeks.

The very last dollar on the bottom of this pile will result in an interest charge for 359 more months if paid on schedule.

An overpayment will reduce the principal and interest will never have to be paid on those dollars again.

Bi-weekly payments and paying extra on principal will reduce the life of the loan.

Budgeting and Financial Planning

Having a budget is not always easy to plan, but it can be a valuable tool to help manage your money. Determining what are absolute necessities, versus wants, can establish the guidelines for success. Mortgage payments, loan repayments, utility bills, and so on are necessary payments each month. Maybe buying a boat or RV are wants but not necessities and the purchase of them should be put off. With careful budgeting, these items may be acquired sometime in the future.

Many financial planners/advisors say that everyone should have 3 to 6 months expenses safely put away for emergency situations. I will be the first to admit that this is not practical for many families as they are starting out. Many are lucky to just get by pay check to pay check. By carefully tracking each month's expenses versus income, you will have an idea of how much money is needed each month and where each dollar goes. Many people feel that having a "Nest egg" isn't as important as it once was, because credit cards can help bail us out in times when we don't have money that we need for unexpected expenses. The difference is that money "borrowed" by using a credit card has to be paid back, with interest if you cannot pay the entire amount during the grace period.

The old adage of paying yourself first may seem unreasonable, but there are ways this can be done without putting too much strain on your budget. It has been said that we don’t miss something we don’t see. One way we put away money for the future was by acquiring U. S. Savings Bonds through payroll deduction. While bonds are not in favor by a lot of people now, they were an easy way to put money aside that we did not miss. During the financial fiasco that started in 2009, those bonds had a much larger return than any other investments that we had. They also were another way to be more diversified.

Probably the easiest way for current employees to pay themselves first is to participate in the Thrift Savings Plan. FERS employees should be putting in enough to get the full amount they can from the employer match. When you do a percentage contribution, any time your salary goes up, your contribution also goes up.

A budget, if faithfully followed, can be a very valuable tool in money management.

Budgeting And Financial Planning-Summary

Prepare A Budget

Follow The Budget As Closely As Possible

Pay Yourself First

Establish An Emergency Fund

Put At Least Enough In The TSP To Get The Match

The Rule of 72

The rule of 72 is a formula to determine how savings can grow if the dividends are left in an account to also grow. The formula tells you how long it will take for your account to double, assuming that you leave all earnings in the account, and do not add any more money to the account.

The way the rule works is to divide 72 by the rate of interest you are earning.

An example is:

72 divided by an interest rate of 4% would mean it would take 18 years to double your money.

Other examples are:

An account earning 6% would double in 12 years.

An account earning 8% would double in 9 years.

An account earning 9% would double in 8 years.

These may sound like unreasonable rates, and they are for savings type accounts at this time, but the same rule can apply to retirement accounts that are invested in stocks, bonds, mutual funds, and investments in the Thrift Savings Plan.

There was a time when savings accounts would provide returns similar to the ones in the examples. That certainly is not the case now. The bank where we have our checking accounts is currently paying .01 percent on savings accounts. That means $100.00 would earn 1 cent of interest in a year. How long would it a take using the rule of 72 for any amount in these accounts to double?

72 divided by .01 percent =   ?

Tax Law Changes

The American Tax Code will have many changes that will take effect for 2018. Most people will see a reduction in the amount of taxes that they will owe. Some filers who have large state and local tax bills and who itemized deductions could actually pay more under the new rules. This is because the amount allowed for income, property and other taxes owed to state and local governments is capped at $10,000.The Standard Deduction will increase from $6500 for single people, $13,000 for a couple, to $12,000 for single people and $24,000 for couples. The $4150 per person personal exemption, which taxpayers could claim for themselves and all dependents, will be gone. This could hurt large families who could multiply $4150 times the number of people in the family, but that may be made up by a doubling of the child tax credit to $2000 from the current $1000.

Another area that could affect taxpayers when they file next year is an adjustment (Reduction) in the amount of withholding from your checks each pay period. The current Secretary of the Treasury would like to see no one receive tax refunds when you file in 2019. I believe part of the reason for this is that if people get $10 or $20 or $30 more in each check, the belief is that they will spend it during the two weeks until the next pay period. This will help to stimulate the economy in the short run, but people will not have tax returns to spend on larger ticket items when they file in 2019. There is also the possibility that not enough will be withheld and some people will not only find out that they don’t have a refund, but will actually owe additional tax when filing their return.

The same scenario happened several administrations ago. We were concerned about having enough Federal tax withheld so we requested an additional amount be withheld each pay period. This assured that we would not have to pay in and would maybe have enough extra to get a refund. You may want to check your pay stub and determine if less money is being withheld for Federal tax, and figure if the lesser amount would leave you with no tax return, or even coming up short next tax filing season. Additional withholding can be achieved by filling in the requested amount on line 6 of Form W-4.

Thrift Savings Plan

The Thrift Saving Plan is a retirement and investment plan for Federal employees and members of the uniformed services. It was established by Congress in the Federal Employee Retirement System Act of 1986 and offers the same types of savings and tax benefits that many private corporations offer their employees under 401(k) plans.

When first rolled out, there were three choices of plans: The G fund, which was Government Securities (Specially issued to the TSP; The F fund, which was comprised of Government, corporate, and mortgage-backed bonds; and the C fund, comprised of stocks of large and medium-sized U. S. companies. Since then two more individual funds have been added; the S fund, comprised of stocks from small to medium-sized U. S. companies not included in the C fund; and the I fund, comprised of international stocks from more than 20 developed countries.

In addition, a series of L funds have been added which target future retirement dates currently as far out as 2050. These funds do the adjustments that are recommended at different stages as retirement approaches. They are in riskier investments when a long way out, but get more conservative as the retirement date approaches. One of the L funds has been retired; the 2010 fund was retired on December 31, 2010. These funds are recommended for people who do not want to make their own decisions on which funds to be in, or when changes should be made.

If you are in the FERS retirement system and you contribute 5% of your salary, you'll get an additional 5% from the government, 4% coming from matching and 1% coming from an automatic contribution made regardless of your level of participation.

One of the best features of the Thrift Savings Plan is its cost. The plan's expense ratios on its investment options are extremely low, and the TSP said its average cost was just 0.029% in 2015. That means for every $10,000 you have in the plan, you'll pay just $2.90 per year in fees. A 401 (k) plan with the same amount of money could cost $100.00 or more.

One draw-back has been that once you are retired you are allowed only one partial withdrawal from the TSP. Any further withdrawals had three options; withdrawn the balance in a lump sum, start monthly payments based on life expectancy, or purchase an annuity. This lead too many retirees withdrawing the entire amount in their TSP accounts. They would not have immediate tax consequences if this was rolled into an IRA. The TSP Modernization Act of 2017 will change that. When implemented it will allow multiple, partial post-separation withdrawals amongst other changes that provide much more flexibility for withdrawals.

Thrift Savings Plan- Summary

The Thrift Savings Plan was started in 1986

Five individual funds plus a series of L funds are available

FERs employees can receive up 5% matching funds

Civil Service employees can contribute to the fund but do not receive any matching funds

Very low expense ratios are a feature of the TSP

Future changes will feature more withdrawal options for retirees.