Financial Literacy

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What is Financial Literacy?

Financial literacy is about understanding concepts like budgeting, building and improving credit, saving, borrowing and repaying debt, and investing—and having the ability to apply them to real-life situations.

If financial well-being is the goal, financial literacy can be the first step toward achieving it! Becoming financially literate means learning basic concepts so you're able to make better-informed decisions about your money and work toward your financial goals.

There's no wrong time to make efforts to improve your financial literacy, and there's always something new to learn when it comes to personal finance. The more financially literate you become, the more it could help you take actions that may ultimately bring you closer to a state of financial well-being.

The 5 components of financial literacy

1. Budgeting
2. Building and Improving Credit
3. Saving and Investing
4. Borrowing and repaying debt
5. Preventing Identity Theft

BUDGETING

A key first step to take as you build your financial literacy is to learn healthy spending habits. One way to do this is by learning to budget. You could start by identifying monthly expenses to include in your budget, which can help you track your spending.

Budgeting can help ensure that you’re not overspending on nonessentials. And avoiding extra expenses can create more room for essentials and savings.

The 50-20-30 Method:

This method involves setting aside 50% of your take-home income for your needs, 20% for savings and 30% for your wants.

- **First, determine your monthly income –** money you have available to spend after taxes

- **Figure out a 50% "Needs" target –** Required monthly expenses

Calculate 50% Needs: Multiply your monthly income by 0.50. For example, if your after-tax income is $3,000, your Needs budget is $1,500.

Monthly income ($3,000) x 0.50 (**50%**) = $1,500 **(target Needs budget)**

A good goal, then, would be to spend no more than $1,500 per month, or 50% of your available monthly budget, on required expenses.

The 50-20-30 Method:

- **Determine your 20% “Savings” target:** Savings are an important part of any balanced monthly budget. Having money in savings means you’re less likely to go into debt to afford a big-ticket item or pay for an unforeseen expense.

Keep in mind that debt payments (other than a mortgage) are also included in the 20% savings percentage. Why? Simplicity. After paying off student loans, credit cards or car loans, you can redirect that same money into a savings account.

Calculate 20% Savings If your monthly, after-tax income is $3,000, your Savings budget is $600.

> **Monthly income** ($3,000) x 0.20 **(20%)** = $600 **(target Savings budget)**

The 50-20-30 Method:

- **Figure out your 30% "Wants" target:** Is it OK to budget for fun stuff? Absolutely! Leaving a little room in the family budget for enjoyable things can keep everyone from feeling deprived.

The Wants budget bucket includes expenses for all the "extras"

Calculate 30% Wants Using an after-tax income of $3,000, your Wants budget is $900.

Monthly income ($3,000) x 0.30 **(30%)** = $900 **(target Wants budget)**

- **Add it up: 50 + 20 + 30 = 100% balanced family budget**

The Envelope Method:

This involves creating categories for all your monthly expenses and putting certain amounts of your take-home income into physical or digital envelopes for each category.

Each category is assigned a set amount of money. Once the cash in each envelope is gone, you're done spending until more money is added, which is typically at the start of a new month or pay period. The idea is to split up your money according to how much you want to spend in each category—and then only let yourself spend until the cash in each envelope is gone.

Envelope budgeting works best for variable expenses, like groceries and dining out, which change slightly every month depending on your spending habits. These are the ideal types of expenses to include in envelope budgeting and make into spending categories.

The Envelope Method:

Here are some categories that may be included when using this type of budget:

- Groceries
- Entertainment
- Dining out
- Gas
- Clothes
- Personal care items
- Managing subscriptions
- Miscellaneous

The Envelope Method:

- Figure out your total monthly income from sources like your job, side hustle, investments, alimony or child support payments.

- Evaluate your current expenses and break them down into categories. Remember, the envelope system is usually focused on variable expenses, like groceries and gas, which change slightly every month.

- Once you've chosen which variable expenses to set aside money for, write each category name on its own envelope.

- Pick the dollar amount you want to allot to each category and write the amount on the envelope. If you're unsure of how much to assign to a category, you could refer to bank statements from the past few months for a better idea of how much you spent in those categories.

The Envelope Method:

- Once you get paid or receive money, take the funds out from your bank or an ATM. Divide up the cash and put the designated dollar amount in each envelope according to what you decided and wrote on each envelope before.

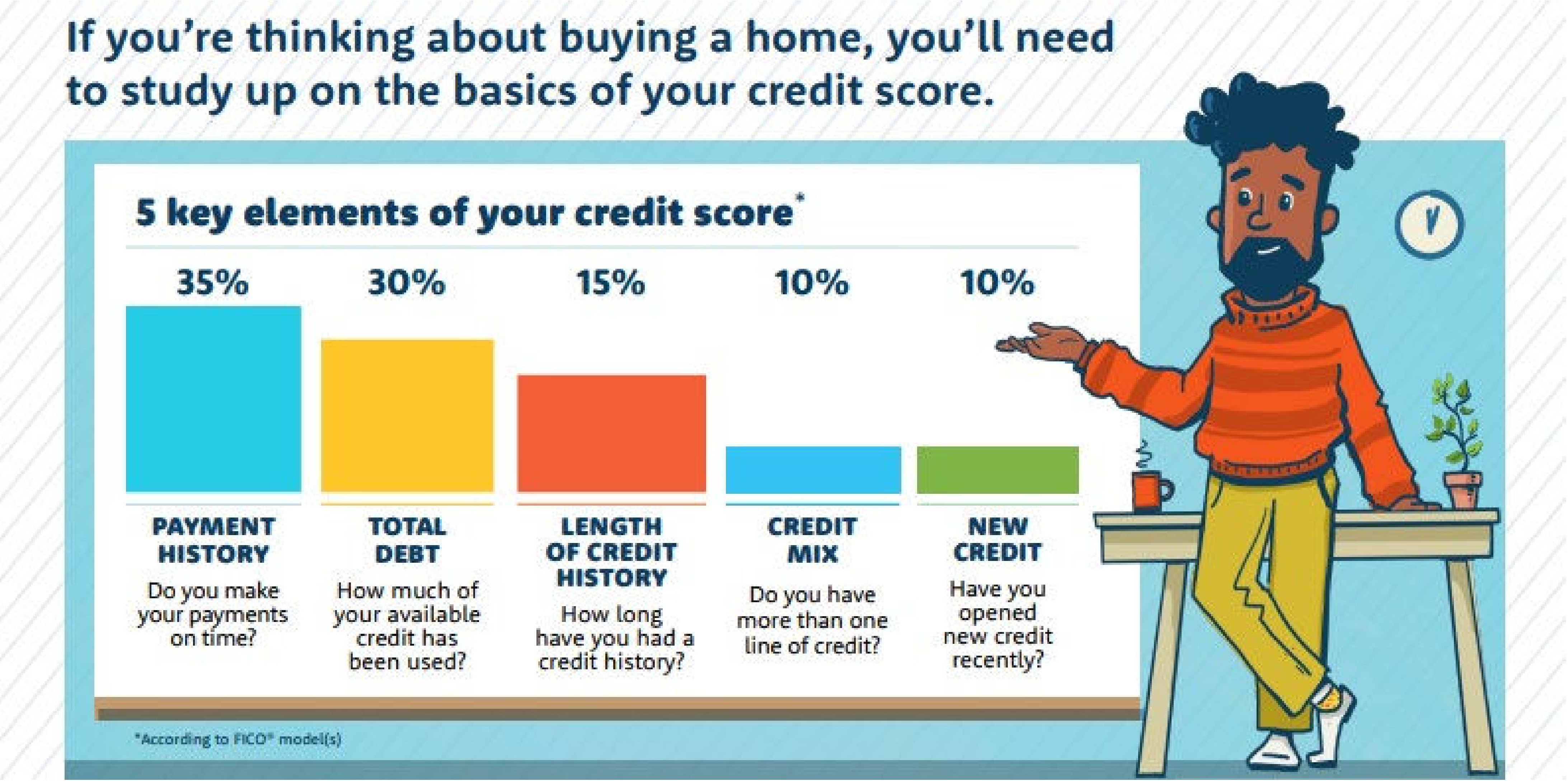
- Once all your cash is divided up, you're ready to use the money from each envelope as needed. To make it easier to see how much you have left, you can consider writing down what you spent—or how much is left—on the back of the envelope every time you take money out.

- When you've used all the money from an envelope, the idea is to avoid spending any more in that category until the envelope is replenished with more cash.

- You can dip into another envelope to cover an expense if needed. But if you're repeatedly needing to do this, you may want to adjust your budget.

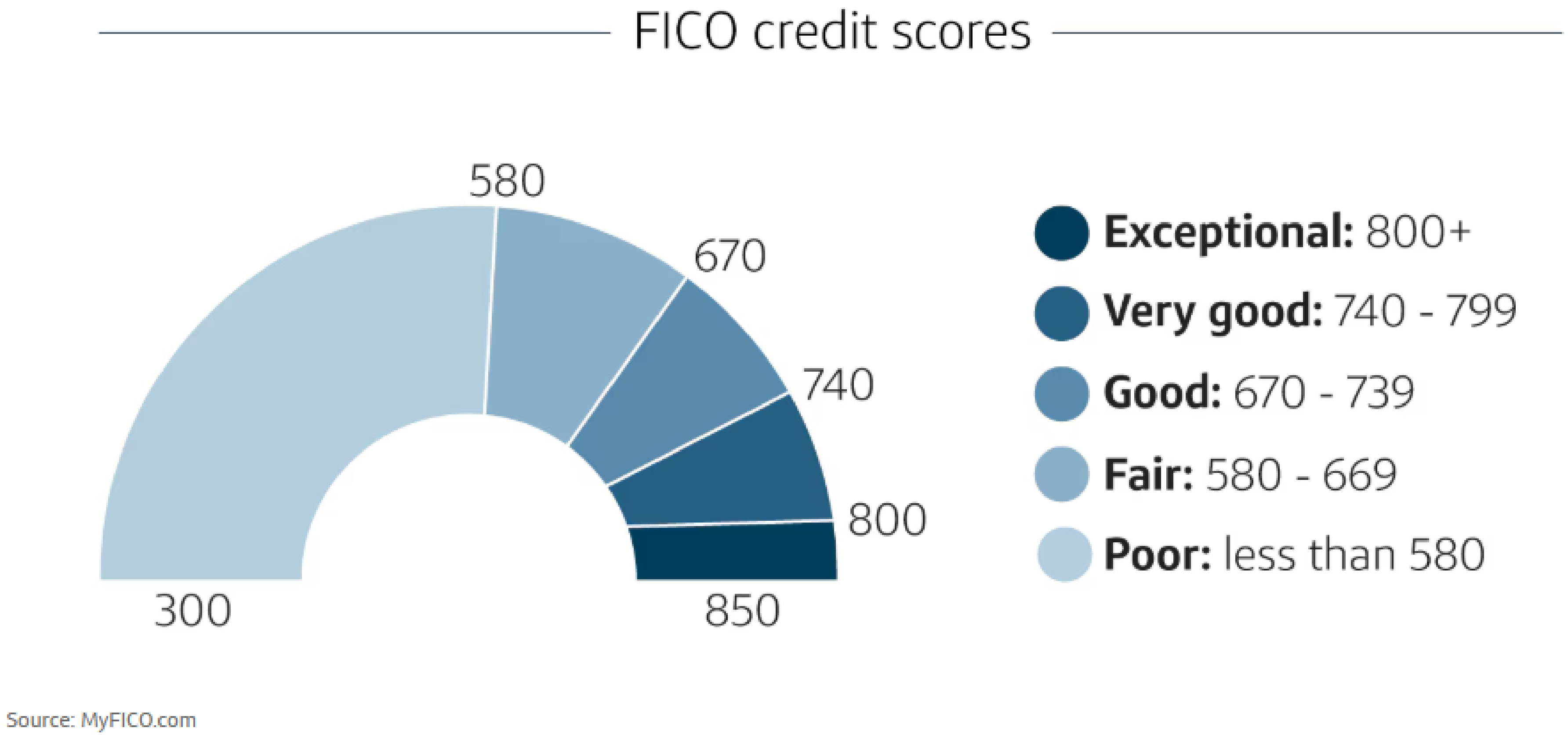
- Money that's left in any envelopes at the end of the pay period or month can be saved for next month or used to build an emergency fund, save for a trip, or pay off debt.

Building and Improving Credit


If you're thinking about buying a home, you'll need to study up on the basics of your credit score.
5 key elements of your credit score*
35%
30%
15%
10%
10%
PAYMENT HISTORY
Do you make your payments on time?
TOTAL DEBT
How much of your available credit has been used?
LENGTH OF CREDIT HISTORY
How long have you had a credit history?
CREDIT MIX
Do you have more than one line of credit?
NEW CREDIT
Have you opened new credit recently?
*According to FICO® model(s)

What is a good FICO score?

A good credit score falls between 670 and 739. Scores in that range are near or slightly above the U.S. Average credit score. FICO's highest credit score is 850, and it breaks its scores into the following five categories:



Understanding what affects your credit score can help you work toward building a healthy credit history and a good credit score over time.

Good credit scores are important because your credit scores can affect your ability to qualify for credit, as well as the rates and terms of the credit you do qualify for:

- A poor to fair credit score could make it more difficult to qualify for many credit cards and loans. If you do qualify for an account, you may have to pay high fees and interest rates if you don’t pay your balance in full each month. You might need to start with a secured credit card or credit-builder loan to build your credit.
- A fair to good credit score may qualify you for more options, but you won’t necessarily receive the best rates or terms. You might find you can qualify for an unsecured credit card but have a harder time qualifying for a premium card.
- A good credit score could give you a better chance of qualifying for a card offering benefits like cash back and travel rewards. It may not have the best rates or terms though.
- A very good, excellent or exceptional credit score could qualify you for the best products with the lowest advertised rates. While creditors consider other factors when determining your eligibility and rates, your credit score likely won’t be what’s holding you back.

4 ways to build good credit

1. **Pay your bills on time.** Consider setting up automatic payments or electronic reminders to help you remember to make on-time payments.

2. **Stay below your credit limit.** Experts recommend keeping your credit use below 30% of your available credit across all your credit card accounts.

3. **Apply only for the credit you need.** If you apply for multiple credit cards and loans over a short period, credit card issuers and other lenders may think your financial situation has worsened.

4. **Check your credit reports.** Because your credit scores are based on the information in these reports, errors can hurt your credit scores. www.annualcreditreport.com

Saving and Investing

Saving

Learning to save is another important aspect of financial literacy. Saving can be done in many ways, including through traditional savings accounts, retirement savings funds, investment portfolios and emergency funds.

It can be helpful to clearly define your savings goals so you know exactly how much you'll need to put aside. Managing bills and other expenses at the same time can make saving seem difficult, but it is possible to save money while paying off debt by using a budget you will stick to.

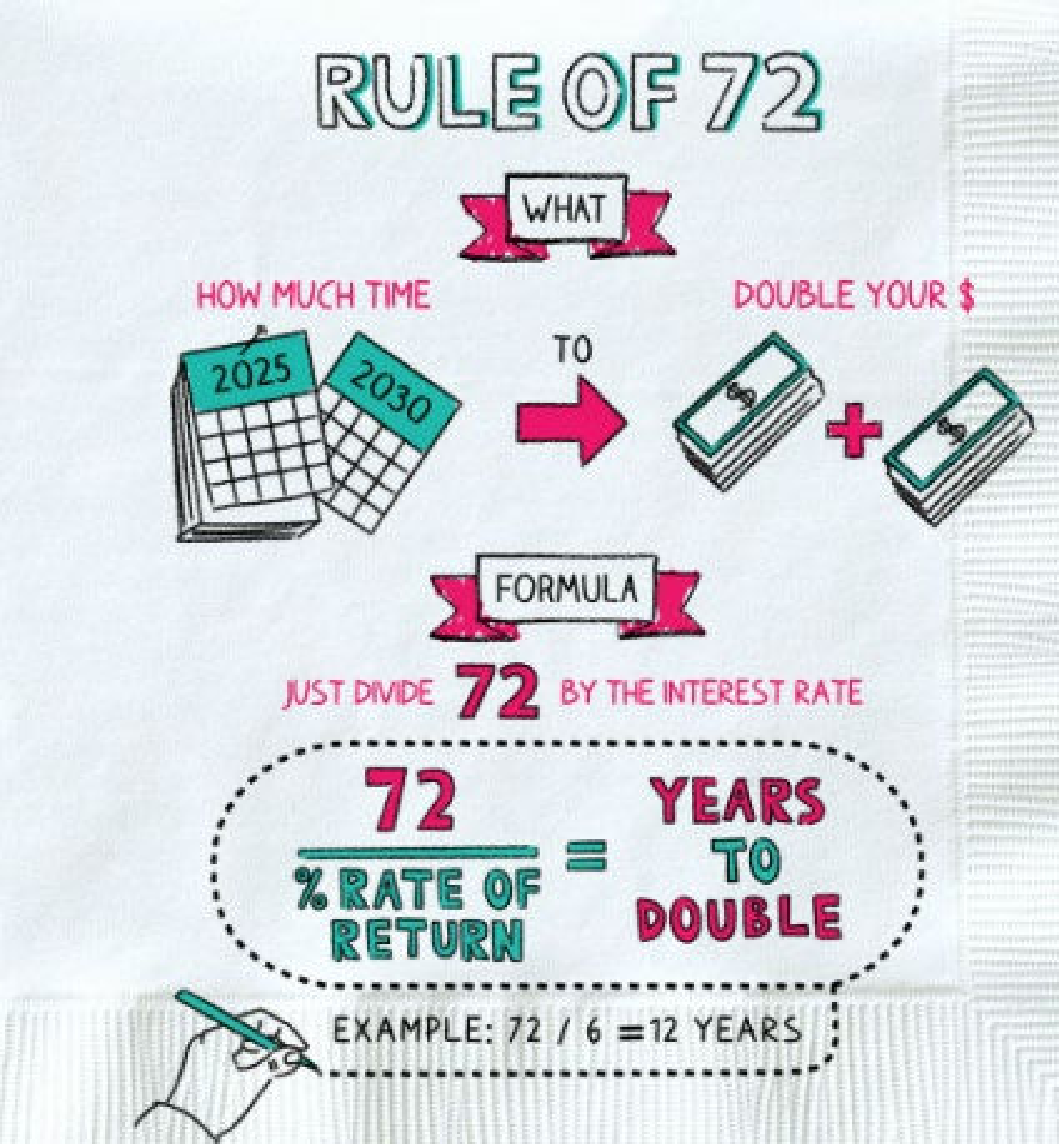
Investing

Once you've strengthened your grasp on budgets, credit, savings and debt, it can be wise to begin educating yourself on additional ways to build wealth and save for retirement.

Learning about stocks, bonds, mutual funds, and other types of investment opportunities might be a place to start. But it's important to remember that investing involves risk. And there are different levels of risk and return, depending on the investment.

Life insurance is another great tool that many financially savvy people use to protect their assets and build generational wealth.

The Rule of 72



Rule of 72

The higher the interest rate…

The less time it takes your money to double

$72 \div$

1% = 72 years to double

4% = 18 years to double

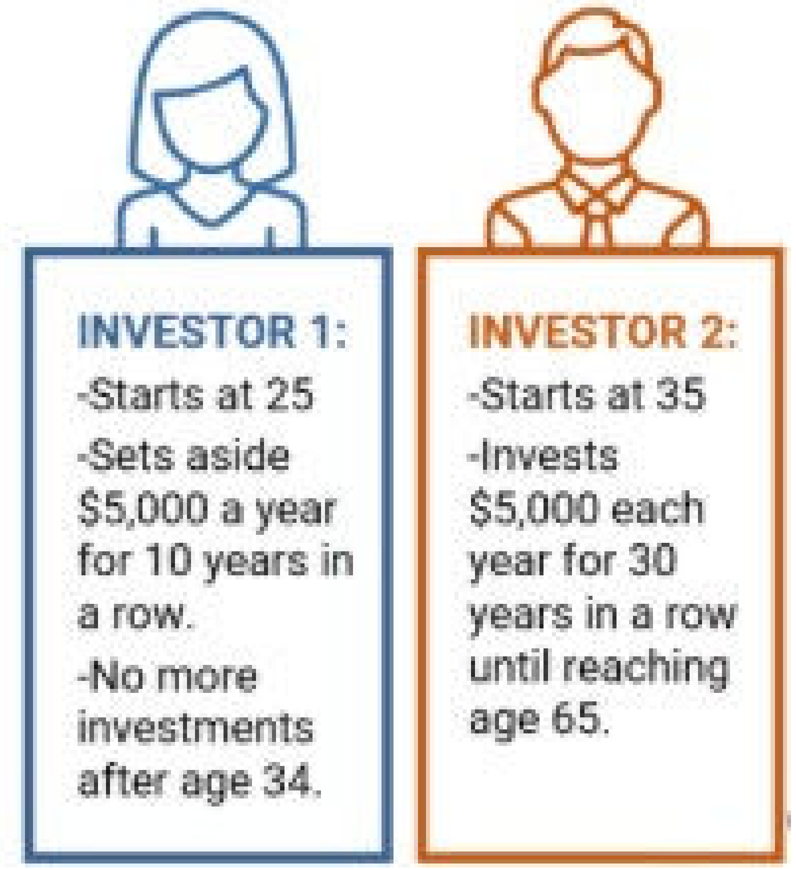
8% = 9 years to double

12% = 6 years to double

18% = 4 years to double

Compound Interest

Who will earn more?



COMPOUND INTEREST:
WHO WILL EARN MORE?
This example shows how the earlier a person takes advantage of compound interest, the more time that money has to grow.
INVESTOR 1:
-Starts at 25
-Sets aside $5,000 a year for 10 years in a row.
-No more investments after age 34.
INVESTOR 2:
-Starts at 35
-Invests $5,000 each year for 30 years in a row until reaching age 65.
$787,180
at age 65
$611,730
at age 65
$800,000
$700,000
$600,000
$500,000
$400,000
$300,000
$200,000
$100,000
25
30
35
40
45
50
55
60
65
NOTES: Assumes an 8 percent interest rate, compounded annually. Balances shown are approximate.
SOURCE: Author's calculations.

Borrowing and repaying debt

Borrowing and repaying debt

At some point in your life, you'll likely need to borrow money and take on some kind of debt to achieve a personal or financial goal or need, like attending college or completing renovations on your home.

Personal loans, mortgages and auto loans could all impact your credit and your financial situation by increasing the total amount of debt you have at any given time. And the more loans you have, the more you'll have to pay toward your debts each month. But those same loans can make it easier for you to afford items that may otherwise be a financial stretch.

Credit cards are another form of debt that can help with more than just everyday expenses. With responsible use, you can use a credit card to build credit. That means doing things like paying your statement balance on time each month and monitoring your credit utilization.

Understanding the impact that taking on debt will have on your finances and establishing a concrete plan for paying down that debt and paying it on time are crucial when it comes to being financially literate.

Real Life Mortgage Example:

Purchase price = $350,000

Down payment = 5% ($17,500)

Loan amount = $332,500

Credit score = 740

Base Interest rate = **6.50%**

Monthly principal and interest payment = $2,101.63

30-year term = $756,586.80

Real Life Mortgage Example:

Purchase price = $350,000

Down payment = 5% ($17,500)

Loan amount = $332,500

Credit score = 670

Base Interest rate = 6.50%

Credit score adjustment = .50%

Interest rate = **7.00%**

Monthly principal and interest payment = $2,212.13 ($110.50 more each month)

30-year term = $796,366.80

($39,780.00 more for the same house!)

Real Life Mortgage Example:

Purchase price = $350,000

Down payment = 5% ($17,500)

Loan amount = $332,500

Credit score = 640

Base Interest rate = 6.50%

Credit score adjustment = 1.00%

Interest rate = **7.50%**

Monthly principal and interest payment = $2,324.89 ($223.26 more each month)

30-year term = $836,960.40

($80,373.60 more for the same house!)

Preventing Identity Theft

What is Identity Theft?

Identity theft is when someone uses your name or personal information to commit fraud in your name, such as:

- Going on a shopping spree with your credit card
- Signing up for services in your name
- Making claims on your health insurance plan
- Claiming your tax refund before you do
- Committing crimes and pinning the blame on you

Identity theft can cause lingering damage to your good name and credit standing. Cleaning up the mess can be expensive and time-consuming. It's important to protect and minimize your chance of identity theft.

How to Lower your risk of identity theft

There are many ways thieves can steal your identity from high-tech ploys to lowly means.

Make it difficult for thieves to get their hands on your personal information to reduce your risk

- Don’t give out personal information over the phone, internet or through the mail.
- Use caution with emails from strangers.
- Don’t overshare on social media.
- Use strong passwords.
- Safeguard your personal information
- Be careful when disposing anything with your personal information
- Protect your social security number.
- Stop pre-approved credit offers - www.OptOutPrescreen.com
- Stop other “junk mail” and telemarketing – www.DoNotCall.gov

Signs your identity may have been stolen:

- Unexpected account statements for credit cards you didn’t apply for.
- Unexpected denial of credit or much higher interest rate offered than expected.
- Bills you expect to receive in the mail didn’t arrive.
- Calls or letters about a purchase you didn’t make.
- Inaccurate information on your credit report.
- Bills from medical providers for services you didn’t use.

Questions?

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