

## Now's The Time To Clean Up Your Finances

By Sharon Epperson  
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It's never too soon (or too late) to take charge of your financial situation and get on the right track. The hard part is figuring out where to start. With some diligence and the following tips, though, it is possible, even if you're on the brink of bankruptcy.

### Creating a Budget

Creating a budget is easy, sticking to it is a little more challenging. First you have to track the money that's coming in and going out.

- 1) Review your pay stubs and write down how much money you can count on every month.
- 2) Next list your expenses. Put your savings at the top of the list, so you don't forget to tuck money away for emergencies. You don't want to live paycheck to paycheck. Making sure you pay yourself first is the best way to avoid falling into that trap.
- 3) After savings, write down you biggest bills, like mortgage/rent, car payment, and child care expenses.
- 4) Then add the expenses that are about the same every month (groceries, utilities, phone, etc.)
- 5) Credit card and other debts? Include at least the minimum monthly payment and add a little more if you can. Ultimate goal: pay the full balance on your credit card every month.
- 6) Finally, try to think of all of the other expenses that often creep up every month (hairdresser, pet supplies, dining out). Make sure they're also on the list.

I love the Budget Wizard tool at [www.beehive.org](http://www.beehive.org). It remembers to ask you about expenses and debts that you may have forgotten and lets you to update your finances to see if you're staying within your budget.

### Sticking to a Budget

Making purchases with a debit card (you'll have an automatic record online) or keeping all of your receipts in a big brown envelope can help you keep track of your spending. But will making note of every latte or iTunes download keep you from breaking your budget? I try to follow "The 60% Solution" – a plan that MSN financial editor Richard Jenkins came up with to help his family stay on the right financial course. No more than 60% of your gross income can go to committed ("fixed") expenses (i.e. all taxes – including taxes withheld from pay, rent/mortgage, utilities, food, clothing, transportation, insurance, child care, etc.). The 40% of your income is split between savings and "fun money".

#### The 60 Percent Solution

- 1) Committed expenses/"fixed" monthly expenses (60 percent)
- 2) Retirement savings and/or debt repayment (10 percent)

- 3) Long-term savings/emergency fund (10 percent)
- 4) Short-term savings/irregular expenses (10 percent)
- 5) Fun money (10 percent)

The key is keeping your “fixed” monthly expenses down, so that you actually have “fun money” left over to spend on anything that you want.

### **How to Save When You’re Living Paycheck to Paycheck**

Living paycheck-to-paycheck? Make sure the first bill you pay is to yourself. Every dollar of your pay goes to expenses, you say? You need to figure out what you can cut.

Have you stopped the magazine subscriptions, the premium cable TV channels, and weekly manicures? Do you check out the “unit price” on items at the grocery store to find less expensive products? Are you bringing your lunch to work? You need to try to cut at least 3-5% from your expenses. View it as a 3-5 percent pay cut, take that percentage of your pay and have it automatically deposited into a savings account.

Build your savings over time, adding a percentage or two until you’re saving at least 10% of your pay. When you get a bonus or a raise, continue to live off your current income and devote the amount of your pay increase in savings. Your ultimate goal: saving 20% of your gross income – extremely difficult at first, but doable if you’re disciplined about saving.

Skip a few manicures and pedicures, bring your lunch and buff up your savings.

Figure out what expenses you can cut to stash away just \$40 a week over the next 50 weeks and you’ll have saved \$2,000 — a sizeable sum for your emergency fund (in case the car breaks down or you have an unexpected household or medical expense). Now that you’re in the habit, save the same sum next year and tuck it into an IRA.

By squirreling away \$2,000 a year from age 22 to 50, assuming your money earns 8% a year on average, you’ll have amassed \$207,900. If you start saving that annual sum a decade later, you’ll only have saved \$82,900 by your fiftieth birthday. A 32 year-old woman would have to save an additional \$3,000 a year to catch up to the 22-year-old. So even if you’re paying off student loans or credit card debt, don’t skip putting some money away.

Add more money than you think you’ll need to your “emergency fund.”

Only you know how much of an emergency cushion will let you rest easy. Many financial advisers say keep 3 to 6 months worth of living expenses. But in times like this when job security is so uncertain, padding your cash reserve with a few extra dollars — perhaps 20 percent more than you think you’ll need — is extremely prudent. To quickly boost your short-term savings:

- Save your tax refund. Don’t spend your tax refund, if you’re lucky enough one. Put the money in your emergency savings rather splurging on that trip to Cancun.
- Redirect a portion of your 401(k) contributions to “emergency” savings. Have a portion of the sum that’s deducted from your pay and sent to your 401(k), automatically sent to your bank savings or money market account.
- Keep stash of cash in Roth IRA. Contributions to a Roth Individual Retirement Account are always yours to take out as you wish. If you don’t have cause to dip in that pot and keep the money in the Roth until you’re 59 ½ years old, you’ll be able to take out your contributions and earnings tax-free.

## **Roth IRA: A Great Place to Save**

A Roth IRA is a great place to park your short- and long-term savings. This type of individual retirement account is different from a traditional IRA because it is never tax-deductible and, therefore, regular contributions can be withdrawn at anytime tax-free. That makes it a terrific spot to stash cash for your emergencies. If you wait until you're 59 ½ to take the money out, earnings on your money are also tax-free — making it a great retirement savings vehicle too. Ideally you should have a separate emergency fund and retirement savings account, but many people can't afford to do both – at least initially.

You can still make 2007 contributions to a Roth until April 15 of this year (up to \$4,000 for individuals or \$8,000 for couples filing jointly). Contribution limits for 2008 increase to \$5,000 for individuals. (Those age 50 and older can contribute an extra \$1,000 each year). You can contribute to a Roth even if you're covered by your company's retirement plan, but there are income limits. If you make over \$101,000 (or \$159,000 for joint filers), you won't qualify for a full contribution.

## **College vs. Retirement Savings**

Don't feel guilty about saving for your own retirement before putting money away for your child's college education. After all, there's no financial aid for retirement. So if your employer offers a 401(k), make sure you're contributing at least up to your company's matching contribution, before funding a college savings account. You don't want to miss out on that free money. You may also consider putting your long-term savings in a Roth IRA, which also lets you withdraw contributions for college expenses at any time tax-free. Leave the earnings to grow until age 59 ½ and you can withdraw them tax-free too – a nice stash for retirement. Go to [www.savingforcollege.com](http://www.savingforcollege.com) to check out 529 college savings plans offered by your state and others – probably the best savings vehicle for money specifically earmarked for college. Contributions and earnings can be withdrawn tax-free to cover “qualified” higher education expenses, such as tuition, fees, books, supplies, room and board.

## **Taking a 401(k) Loan to Pay Off Debt – Part 1**

Thinking about taking a loan from your 401(k) to pay off credit card debt? Don't do it. Finding a way to cut other expenses and systematically pay off the debt (without incurring any more) is the ideal way to pay it off. If you don't pay back the 401(k) loan on time and you're under 59 ½, you'll owe a 10 percent penalty for early withdrawal plus federal and state income tax on the money. Plus, if you're laid off or quit your job, 401(k) loans generally have to be paid off within 90 days, or in some cases, immediately. Sure the interest rate on a 401(k) loan, usually 1-2 points above the prime rate, is less than that on the average variable rate credit card, about 13%, but you lose out on the tax advantages and compound interest on the money had it been invested. It's not worth it. Want proof? Check out tomorrow's post where I run the numbers.

## **Taking a 401(k) Loan to Pay Off Debt – Part 2**

To see if it makes sense to use a 401(k) loan to pay off credit card debt, let's just run the numbers. Say you've racked up \$10,000 in credit card debt at 13% interest. It would cost you \$227.53/month to pay it off in five years (\$13,651.80 in total), according to Bankrate.com. Instead, you take the money from your 401(k) to pay off the credit card debt in one lump sum. You're 35 years old and have \$30,000 in your 401(k). You take a \$10,000 loan at 7% interest and stop making contributions to pay back the loan over the next five years. Even if you pay back the loan on that time, you'll have \$19,748 less money in your 401(k) at age 40 than if you had not taken out the loan and had continued to make monthly contributions (assuming an 8% return on investments), says T. Rowe Price financial planner Stuart Ritter. At 65, when you really need that retirement stash, you'll have nearly \$145,000 less than if you hadn't taken out the loan. Again, I say, it's not worth it.

## **Budgeting During Life Changes**

Changes in your life (unexpected or planned) can wreak havoc on your finances even if you've done a pretty good job keeping your spending and savings on track.

Whether you're having a baby, were recently laid off or have become too sick to work, health care expenses are usually the costs that will start to break your piggybank. So make sure you review your health care options.

Sign up for the company's health insurance plan and know what's covered. If you're a new employee or have been relying on a spouse's health care and other benefits, find out what you can get. If you're laid off, you can continue your health insurance through COBRA (though rates will increase instantly and significantly). However, you must have been enrolled in your employer's health plan to get it.

### **Pick Up the Phone and Lower Your Credit Card Rate**

Save hundreds of dollars, maybe thousands, with a five-minute phone call. Fear is in your favor. Credit card companies are often willing to cut interest rates for many of their customers because they don't want to lose the business. So make that call. But first, be sure you have a strong leg to stand on.

Order a copy of your credit report from [www.annualcreditreport.com](http://www.annualcreditreport.com) and get your credit score (ranging from 300 to 850). Credit card companies usually reserve the lowest rates for customers with the highest credit scores. Next, compare rates on your credit cards. Call the credit card company with higher rate card and tell them you're thinking of canceling your account and going with a lower rate card unless they match it.

Once you get the lower rate, make your payments on time, or you'll incur late penalties and then you could get wind up paying a higher interest rate all over again. If your credit card company denies your request to lower the rate, try rolling over credit card balances to different cards at introductory rates. But remember to read the fine print. "Lower", introductory rates often only last for a short period of time, after which the rate will jump up.

### **Sick Over the Stock Market Slump? Hire a Financial Advisor.**

Working with a financial advisor doesn't guarantee you won't lose money when stocks are tanking, but you sleep a little easier knowing you have a diversified portfolio and enough cash savings to get through rough waters. But make sure you check out the advisor before jumping in. See how they've performed in market downturns.

- The adviser should be registered with your state securities regulatory agency ([www.naasa.org](http://www.naasa.org)). See if there have been any complaints.
- Then contact FINRA's Broker Check ([www.finra.org](http://www.finra.org)) that contains background information on brokers and their firms.
- You can also find out if there have been any complaints against the adviser's firm by requesting the full "Form ADV" from the Securities and Exchange Commission ([www.sec.gov](http://www.sec.gov)). Check them out!

Stay-at-home moms, don't stop saving! Keep adding to your nest egg.

You're "on the job" at home, raising kids, taking care of the household. You may not be getting "paid" a salary, but you can still contribute to a retirement account – or your husband can for you. You're likely to live longer than your spouse and that means your retirement stash will have to last longer. So you can't afford to stop saving.

If you have a 401(K) from a previous employer, make sure to put that money in a Rollover IRA to give you more flexibility with your investments. (Another challenge for women: we tend to invest less aggressively than men so our retirement savings grows more slowly.)

To keep socking money away, open a Spousal IRA account. You can contribute up to \$4,000 this year (\$5,000 if you're 50 or older) to a Traditional or Roth Spousal IRA.

Starting a business? Have a cash stash and know where to get financing.

Women-owned businesses make up a quarter of all business in the United States and are the fastest growing segment in our economy. Want to join the ranks? Make sure you've taken care of your personal finances before seeking funding to start your business.

Lenders will look at your credit history and your savings. Consider your annual living expenses and put away enough money to live without an income for at least two years. List all of the start up expenses and projected monthly income and expense for two years as well to determine how much working capital you need to break even.

Always have an exit plan, so you know before you start how much money you're willing to lose or how much time you're willing to invest. Lenders will want to know this information too. Try to save money and use other personal assets to start your business.

After that, seek financing from a financial institution, one of the U.S. Small Business Administration's Women's Business Centers ([www.sba.gov](http://www.sba.gov)), or a non-profit economic development agency like Count Me In ([www.countmein.org](http://www.countmein.org)).

### **Review Adjustable Rate Mortgage Before It Resets**

If you "stretched" to afford your home when adjustable mortgage rates were around 4 percent to 5 percent, you'd probably have a hard time making the monthly payment when the loan resets to over 7 percent. A jump for 4 percent to 7.5 percent on a \$200,000 loan means you'll be paying an extra \$382 a month. Explore your options before your rate changes:

- With interest rates coming down on adjustable and fixed rate mortgages, it may make the most sense to refinance into a fixed rate loan.
- Refinancing to a fixed rate mortgage may not make sense unless you have impeccable credit. Lenders are looking for FICO scores of 720 or better these days. A lower score will result in a higher interest rate, which may not make it pay to refinance.
- Most lenders also now require that you be able to document your income. So get your taxes done early, make sure you have your W2s in hand.
- And you'll likely need to show the loan officer that you have adequate savings to cover not only mortgage payments for the next few months. Many require you have at least 3 months of principal, interest, taxes and insurance.

### **To Sell A Stock or Not To Sell**

When the stock market takes a serious dip, whip out your "sell plan" to figure out if you've really had enough. What's a "sell plan"? Well, before you make an investment, you should have an idea of what kind of return you are hoping for and what you will do once you've reached your mark, or in the worst case, if the investment doesn't pan out. It may be time to sell if:

- Your asset mix is out of balance. (You have a greater percentage of stocks or bonds than you had originally allocated.)
- Your investments have not performed as well as the benchmarks in that sector for the past three years.
- You find another tax advantage to offset the capital gains (which you'll pay taxes on) in other investments.
- You can't stand the losses.
- You've finally reached your goal – you have enough money for your child's education or for your retirement fund.
- Stick to your plan – that doesn't necessarily mean sticking with your investments.

## **Couples Coping With Money Troubles**

To get rid of money trouble, couples often need to give their finances a serious workout. So get together for a “money date” in a relaxed setting away from the kids and chaos of your daily household routine. Take the time to map out short- and long-term financial goals over a glass of wine or a cup of tea. Talk about how you want to live and how much money that will take. Discuss how you plan to pay down debts and reduce expenses. Your goal should be to double your credit card payments or at least pay slightly more than the minimum due. Order your credit reports and scores from [www.annualcreditreport.com](http://www.annualcreditreport.com) and share them with one another. And consider keeping separate checking and savings accounts as well as a joint checking account for household expenses. If one spouse has bad credit, work together to pay down the debt, but don't pool all of your money.

## **Renters Insurance**

Are you a renter? Even if you don't own your home, you need to insure your belongings. What if you're apartment gets broken into or there's a fire? If you own expensive electronics – flat screen TV, computer, digital camera – or exercise equipment or other expensive gadgets, you need renters insurance. Pet owners face increase liability exposure without it. And college students who rent off-campus apartments could be putting their families' finances at risk if faced with a loss or claim. Renters insurance also pays for “reasonable” costs of temporarily living away from your home if you can't live in it due to a fire, severe storm or other insured disaster, like hotel bills, temporary rentals, restaurant meals, and other living expenses. Remember, renters are not covered under the landlord's policy. You need your own. Find an insurer in your state through the National Association of Insurance Commissioners website ([www.naic.org](http://www.naic.org)) or Independent Insurance Agents and Brokers of America ([www.iiaba.net](http://www.iiaba.net)).

## **Identity Theft**

Want to keep your identity your own? Take these precautions:

- Shred financial documents before throwing them away.
- Never give out financial information over the phone or email unless you are certain it is a legitimate company.
- Be careful about co-signing for a loan for friends or even close relatives. The confidential information provided may be used to get unauthorized credit.
- Get a free credit report every year from [www.annualcreditreport.com](http://www.annualcreditreport.com) and make sure to review the report for any errors.
- If you discover that your identity has been stolen, find out what steps to take at [www.consumer.gov/idtheft](http://www.consumer.gov/idtheft).

You may be able to locate an identity theft resolution company through your employer or financial institution to help do some or most of the legwork required to help you file a police report and gather paperwork to help restore your identity.

## **Self-employed Savers**

If you're self-employed, own a small business, a side business, or do some freelance work, you should make sure you're aggressive about saving for retirement.

Here are some savings strategies you should consider:

- Set up a "Simple IRA" if you want your employees to fund most of their nest egg. They can contribute 100 percent of their net income, up to 10-thousand dollars this year. Or up to 12-thousand dollars if they're 50 or older. As a key employee of the company, these limits also apply to the owner.
- If you have no or very few employees, you'll probably find you can stash a lot more cash in a simplified employee pension or "SEP IRA."
- You can put away up to 20% of your net self-employment income (25% of your salary if you're an employee of your own corporation) up to \$46,000.

And sole proprietors with business income under \$220,000 dollars should consider a "Solo 401(k)," which will let you put away an additional 14-thousand this year, up to the \$46,000 dollar limit.

### **Liability Insurance**

You may not want to think about it, but what would happen if you were unfortunately responsible for a serious accident? Would you have enough insurance to cover your assets? Most home and auto insurance policies usually come with a certain amount of liability coverage, but it's probably not enough.

You should consider buying a personal "umbrella" policy to supplement that coverage. If you don't have enough liability coverage and you are sued, then your home and other assets could be at risk.

What's great about umbrella policies is that they cover damage claims that you, your dependents, or even your pets may unintentionally cause.

But they don't cover work-related lawsuits. So doctors, lawyers, anyone with a professional practice, as well as small business owners should think about getting additional liability coverage. This additional insurance should help protect you from malpractice, errors and omissions, contractual disputes as well as personal injury suits. Protect your assets. Make sure you're adequately covered.

### **Lending Money To Loved Ones**

It's hard to say "No" to close friends and family who come to you for cash, but you need to protect yourself since a lot of these loans go bad. About 14% of personal loans end up in default compared to about 1% of bank loans, according to VirginMoney (formerly Circle Lending), which formalizes loans between family and friends. But you still need to formalize and customize terms of a loan to family or friends and come up with a repayment plan. For \$100, VirginMoney will help you set up the terms of the loan, put it in writing and take some of the emotion out of it. Remember, dealing with even the closest relatives can be dicey when it comes to money. You could risk jeopardizing your relationship if there's a problem with them repaying the money.