Dad's Advice on Money

v1.1

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1. Introduction.

When I was growing up, my parents taught me very little about money. Most of what I know, I learned on my own, by making mistakes, by reading magazines, by reading books, and by talking to others. If I have any advice to give, it would be the information that follows. It took me about 17 hours to write this. It will take you much less time to read it. This all started because I had some financial advice that I wanted to discuss with each of you. But I thought, “When can I get them all together? And if I do and I talk to them but it’s not written down, will they remember?” So I decided to type everything about which I wanted to talk to you. As I typed, the ideas kept coming so I just typed everything I could think of regarding each topic. It’s comprised of 22 topics and covers over 40 pages, so I’d just recommend reading one topic each day until you get it done. I thought this was important enough to document and give to each of you so I hope that you’ll take the time to read it. Some portions may not read very well, but that’s because I was typing as fast as I could, trying to keep up with my thoughts as they came. Also, there is scripture for much of this, but I didn’t take time to look it all up.

The pages that follow give you a glimpse of how I have lived my life and what I think is good advice. You do not have to take my advice, though. You are an adult and you can make your own decisions. I just didn’t want you to wake up 5 – 10 years from now and say, “I didn’t know that.” Or, “Nobody ever told me that.” Or, “Nobody ever warned me that doing that could lead to financial problems.” If you have any questions let me know.

2. Live Within Your Means.

First and foremost, you must spend less than you earn. If you don’t, you’ll end up in debt, paying everyone else and you’ll never save money or build wealth. If you read the book “The Millionaire Next Door” one of the basic tenets that’s true of all self-made millionaires is that they learned financial discipline. They learned to save, learned to budget and learned to live within their means.

3. Avoid Debt.

This is related to living within your means. You can never save money or build wealth if you are in debt. If you can’t afford to pay cash for an item, don’t buy it. The only valid exception is the purchase of a house. Houses are so expensive (relative to everything else) that it’s not practical for most people to save enough money to pay cash for a house. By the time you get enough money saved, your children might be too old to appreciate it. I’ll talk more about buying a house later.

Of people between aged 22 – 33, 20% of them have more than $10,000 in credit card debt. And 25% of the people in that age group think they'll never be free of credit card debt. They’ve already lost hope. The best way to avoid being one of these statistics is to avoid debt in the first place.

I did not always avoid debt religiously, but I was always VERY disciplined when it came to debt. I had the following motto: "I will never borrow money for something I want. I will only borrow money for something that is a necessity." The only necessity I ever had was the need to have a car large enough to transport our whole family (it can be argued that that's not really a necessity). So, for almost our entire marriage, your mother and I only borrowed money a couple of times and each of those times was to buy a minivan. But in each case, we put down a very large down payment, financed a relatively small amount and then we paid off the loan as quickly as possible (in less than 6 months).

The only other time your mom and I went into debt was to buy the first lot in Ingram. That was not a necessity, but I looked at it as a life-changing opportunity. I say life-changing because it was planning for our retirement which is a huge change in your life. And I say opportunity because I felt like Hill Country land was only going to appreciate in value so if I didn't buy it then, I'd end up paying two times or three times as much in just a few years. I turned out to be right about that. We paid $3300 per acre for that land and it now sells for $7000 - $8500 per acre. The only other way I could justify going into debt for the Ingram lot was because our house payment was very low and adding in the cost of the loan for the land was still well within our budget. And once again, we put down a large down payment ($12,000 which was 40%) and financed a relatively small amount ($18,000 which was 60%).

4. Types of Debt.

Let's talk about the two kinds of debt:

a) Secured debt. Secured debt is debt for which you put up collateral. For instance, if you get a loan to buy a car, the car is the collateral for the loan. If you don't pay your loan, the bank that made the loan to you will repossess (take) your car. If you get a mortgage to buy a house, the house is collateral for the loan. If you don't pay the mortgage payment, the bank that gave you're the mortgage will foreclose on you (i.e., repossess your house). Do you see who really owns the car and the house? The bank does as long as you have a loan. If you miss a payment, they can come get their collateral.

b) Unsecured debt is debt for which you put up no collateral. A credit card is unsecured debt. If you use a credit card to buy a big screen TV and decide not to pay the credit card, the bank that issued the credit card can't come get the TV. The bank can sue you to get their money, especially if you have the money and you have just chosen not to pay.

As you might guess, the interest rate you pay on secured debt is going to be lower than the interest rate on unsecured debt. The reason is because the secured debt has collateral so there is a very high likelihood that the bank is not going to lose money if you default (i.e., don't pay). The bank is assuming a relatively small amount of risk But unsecured debt has no collateral. Since the bank is assuming a lot of risk, the interest rate will be much higher. For example, a home mortgage may have an interest rate of 5%, a car loan may have an interest rate of 7% and a credit card may have an interest rate of anywhere from 12% to 22%.

5. Types of Loans.

Let's have a quick discussion on the kinds of loans and down payments on loans. There are several types of loans.

a) Secured loan. This is probably not the real name for it, but I'll just call it that. As we discussed above, this is a loan where the item you are buying is collateral for the loan. A home mortgage, a car loan, a land loan, etc. are examples. One thing to be aware of with a secured loan is that the bank will not loan you the full value of the thing you are buying (i.e., the bank will not finance 100% of the purchase price). By that I mean, you are going to have to make some sort of down payment to get the loan. If the bank were to finance 100%, then you really have "no skin in the game." If you have no skin in the game and you encounter tough times, you don't have a lot of incentive to keep paying on your loan. The bank has a higher likelihood that it will need to repossess the item being purchased. About 10 years ago, banks started making loans with "zero down" (i.e., no down payment) and people just quit paying on their loans. That led to some of the mess that our country is in now. So the banks have recently gone back to the policy of requiring some form of down payment. The higher the down payment, the lower the amount you'll need to borrow and the lower your monthly payment will be.

b) Home equity loan. When you pay on any loan, part of the payment covers the interest payment and the remainder is applied to "principal" meaning it is used to decrease the amount owed on the loan. For instance, let's say you buy a house for $100,000 with a down payment of $5,000 (5% down is very common though I've always put more down). Your mortgage amount is $95,000. That is the amount of principal you have to pay the bank before you actually own the house free and clear. So, at this moment, you own $5,000 worth of your $100,000 house and the bank owns $95,000. You are said to have $5,000 in equity in the house. Let's assume you have a fixed rate mortgage, so let's say that every month your loan payment is $1,000 (this is also called your Principal and Interest payment or your P&I payment because it is used to pay the interest and the remainder is applied to principal). Of that $1,000, let's say $950 goes to interest and the remainder ($50) goes to principal. So, after your first payment, you now owe only $94,950 to the bank and you have $5,050 in equity. The next month comes around and you pay the bank $1,000 again. This time your interest payment is, let's say, $948 (it goes down because you owe the bank slightly less this month than you did last month) so the amount applied to principal is $52. So after two payments, you have $5,102 in equity ($5,000 down plus a principal amount of $50 and a principal amount of $52). This goes on month after month and in 360 months

(30 years), you make your final payment to the bank and you now have \$100,000 in equity in the house and the bank is owed \$0. At any point in time during the 30 year life of your home mortgage, the bank will loan you money and use the equity you've accumulated on your house as collateral. That is called a home equity loan. But keep in mind, what I described above is only one of two ways that you increase equity in your house. When you pay on your mortgage, part of the payment goes toward principal and that creates equity. The other way you create equity in your house is if the house increases in value. Every year, your house's value is appraised by the county (for the purpose of calculating your property tax amount). If the appraisal goes up, then your house is increasing in value. The actual amount of equity you have in your house at any point in time is depicted by the following calculation:

Equity = (Value of House) – (Amount Owed on the House)

Let's go back to our sample mortgage of \$95,000 on a \$100,000 house that we used above. Let's say after paying on the mortgage for 5 years, you have reduced the amount of the loan from \$95,000 down to \$85,000. But let's say in that same 5 years, the price of houses in your neighborhood is going up (people sell houses all the time and appraisals are based on how much similar houses are actually selling for). Let's say your \$100,000 house is actually now worth \$120,000. Your equity in the house is now \$35,000 (value of the house = \$120,000 minus the amount owed of \$85,000). You can think about equity like this. If you sold the house today, how much money would you really walk away with? The answer is, you get whatever is left over after you pay the bank what you owe them. You get to keep the rest. In our example, you sell the house for \$120,000 and pay the bank the \$85,000 you owe them and you get to keep the \$35,000. That is your equity. So, with a home equity loan, you can use the equity in your house as collateral and get a loan to do anything you want to do. The danger is, if you don't pay back the home equity loan, the bank will foreclose on your house. You should be very careful with a home equity loan because you put your house at risk. But home equity loans are tempting because the interest rate is usually low.
One more thing to keep in mind: The bank will usually only allow you to borrow an amount equal to 50% of the value of your equity. The reason for that is because your equity can vary wildly since it is calculated from the appraised value of your home. Also, keep in mind, sometimes the price of houses go down so a bank will only loan you half the equity to protect itself from such an event.

A home equity loan is also known as a second mortgage. If your house gets foreclosed on, the company that wrote the first mortgage (called the first lien-holder) actually takes possession of the house and can sell it to recover the amount it is owed. Guess what happens to the company that wrote you the home equity loan? As the second lien-holder, that company gets what's left over, if anything. For example, suppose your house is appraised at $120,000, and you have a mortgage with Bank 1 for $80,000. By definition, you have $40,000 in equity. So you get a home equity loan from Bank 2 for $20,000 (half of the value of the equity). Let's say you stop paying on your mortgage (the loan with Bank 1 – the primary lien holder). Bank 1 forecloses and sells your house. Bank 1 takes the first $80,000 of the sales price. Bank 2 gets whatever is left over to cover the $20,000 they loaned to you. What if Bank 1 could only sell the house for $95,000? Bank 1 gets $80,000 and Bank 2 only gets $15,000. Bank 2 then either takes a loss for $5,000 or sues you for it. And trust me, if this happens, Bank 1 doesn't care about selling the house for anything over $80,000. Think about it. Bank 1 only wants $80,000. As soon as someone offers $80,000, Bank 1 will sell it because they'll get paid. To hold out for a higher price benefits them none (they still only get $80,000) but it costs them money to keep holding out for a higher price. Let's say you kept paying your mortgage but you stopped paying your home equity loan. Bank 2 will foreclose on you and sell your house. But Bank 1 still gets the first proceeds from the sale (the first lien holder always gets paid first) and Bank 2 gets whatever is left over. In this case, Bank 2 will hold out for the best price because they want to make sure Bank 1 gets paid in full and that they get as much money as possible. If Bank 2 were to sell your house for $105,000, then Bank 1 gets $80,000, Bank 2 gets $20,000 and you'll get the last $5,000. But this never happens. Think about it. If it was this easy to sell the house for everything that was owed on it, you would've done that yourself rather than going through foreclosure. This explains why the interest rate on a second mortgage (a home equity loan) is usually higher than the prevailing mortgage rate. That is because the second lien holder accepts more financial risk than the primary lien holder so the second lien holder deserves a higher reward.

Another thing to keep in mind: Home equity loans have only been legal in Texas for about 15 years. Prior to that, they were not allowed because the state believed your house was sacred and the state didn't want you to put your house at risk for stupid things. But too many people had too much equity that they couldn't get their hands on, so the state legislature was lobbied to change the law.

The good thing about a home equity loan is that the interest paid on a home equity loan is tax deductible. I'll talk more about that later.

c) Home equity line of credit. Also called a HELOC, it is just a loan that is always available to you, no questions asked, that uses your home equity as collateral. In other words, if you have a $5,000 HELOC, then you can call your bank any time, for any reason and just get your hands on $5,000 with no questions asked, no approval process. This is usually used to do stupid, impulsive things alluded to above, such as take a vacation or remodel a room in your house.

d) Student loan. A loan to cover college expenses. The federal government usually gives good interest rates for student loans, but keep in the mind that student loans are not "bankruptable." That is, they can't be erased by a bankruptcy. We'll talk more about bankruptcy later.

e) Title loan. Similar to a home equity loan but using the equity in your car instead of your house. This is a horrible loan with very high interest rates.

f) Payday loan. This is for people whose finances are completely out of control. You write a check to the "loan company" for an amount greater than the amount of money you need right now. The check is dated in the future for the day you get paid. For instance, on Monday you realize that you want to buy a $200 watch and you have no money but you get paid on Friday. Rather than wait until Friday to buy the watch, you just have to have it right now. So you go down to the payday loan office. You write the payday loan place a check, dated for this coming Friday, for $225. The payday loan office gives you the $200 you so desperately want/need. On Friday they cash your check and keep the $225. Everyone's happy. You got the watch you wanted and the payday loan office got paid what calculates out to an exorbitant amount of interest when you "annualize" it. Think of it like this. You paid an interest payment of $25 for $200 for four days. That's a rate of 12.5% interest over 4 days. Divide 365 days in a year by 4 days and you get about 91. Multiply 91 by 12.5% interest for annualized interest rate of 1,115%!!! People using payday loans have lost complete control of their finances.

One last thought pertaining to loans. Never co-sign a loan for someone else. If a bank is requiring a co-signor it's because the bank has analyzed the potential borrower's credit history and financial status and determined that the potential borrower is a high credit risk (meaning there is a high likelihood the borrower won't pay back the loan). By co-signing a loan, you are agreeing to pay back the loan when the borrower stops paying. Be prepared to pay back the loan. Also keep in mind that entering into financial arrangements with friends and family can ruin your friendships and your familial relationships.

Here are two stories. 1) When your mother and I were first married, I had a buddy from church that got in trouble with the police and I loaned him $250 to pay a traffic ticket (he ran a red light right in front of a cop). The guy was a very nice guy and a good Christian, but he was not financially disciplined. He and I worked out a payment plan where he would at least pay me $20 a month for 12 months. He never made the first payment. After about three months, he moved back to New York. He actually had the nerve to call me about six months later asking to borrow some more money. I told him no, and I never talked to him again. 2) When your mother and I had been married for about 5 years, our friend Prince Couisnard needed a favor. He had a wife and a couple of children and had been living in a friend's apartment. He got a job and was trying to move into an apartment of his own. The power company wanted a deposit of $200 - $300 before they would turn on his electricity. Or they wanted an existing customer to co-sign to pay his electric bill if he didn't pay. So Prince asked me and your mother if we would put up the deposit or co-sign. I told him I didn't like either option. But here was a guy with a huge heart who was trying to get his life straightened out. We talked at length and I decided to co-sign for his electric bill. He called me about 4 months later and told me that he'd had some unexpected expenses and had missed a payment and that the power company would be sending me a bill. He was very apologetic and promised to pay me back. I got the bill and paid it. Sure enough, he did pay me back a couple of weeks later,.and then he made the remainder of his payments on time. After 12 months of consistent payments, a co-signor was no longer required. It strained our relationship a little bit, but because I trusted him and he didn't betray that trust, we are friends today.

The moral of the story: Don't co-sign for someone else unless you are willing to pay the bill, because you'll likely get stuck with the payment.

6. Types of Home Mortgages

There are basically two types of mortgages, fixed rate and adjustable rate. There are a couple of different flavors of adjustable rate mortgages. And about 99% of all mortgages are either 15 year duration or 30 year duration. The 15 year variety will typically have a higher interest rate than the 30 year variety (the banks want to attract you to the longer mortgage with the lower rate because then you'll be paying them longer). The good thing about home mortgages is that the interest on a home mortgage is tax deductible. We'll talk more about that later.

a) Fixed rate mortgage. The interest rate is fixed over the life of the loan. Since the interest rate never changes, the amount of your monthly payment is the same (fixed) for the life of the loan. This is the only type of mortgage I would ever get!

b) Adjustable rate mortgage. Also called an ARM. The interest rate can change every year based on the economy. When the economy is good, your interest rate may go down and so will your monthly payment. But when the economy is bad, your interest rate may go up and so will your monthly payment. If you're on a tight budget, then you may not be able to afford the increase in the monthly payment and you could lose your house. The banks try to make you feel better about ARM's by limiting the amount the interest rate can change every year (i.e., the interest rate can neither increase nor decrease more than 1% in any 12 month period). But guess what happens if it goes up 1% every year for 5 years? I would never get an adjustable rate mortgage.

   There are a few variations on ARMs:

   A Balloon mortgage is a nasty little mortgage where the payment is very low in the first several years and then "balloons" (i.e., increases significantly) toward the end of the mortgage. It may balloon so much that you can't afford to pay it and you lose your house. The banks convince you it's OK because they say, by the time it balloons, you'll be making more money and you'll be able to afford the increased payment. Or, you will probably have sold the house and moved before it balloons. But guess what? When your payment is low, it is so because you're only paying the interest on the loan and you're not paying down the principal. So you may not be building any equity. You're basically paying rent and assuming a lot of financial risk.

An Interest-Only mortgage is just that. It's a mortgage where you're just paying the interest and not paying any principal so you may not be building any equity in the house. By going "interest only" you may be able to afford the payment, but you're not buying anything. You might as well just be paying rent.

You may also hear the term "Jumbo mortgage." A jumbo mortgage is just a very large mortgage. The amount fluctuates every year but it's something around $400,000. These loans get some special treatment (and maybe lower interest rates) because of their size.

c) Assumable mortgage. This is not really a type of mortgage. Rather it is just an attribute of a mortgage. If a mortgage is assumable, it just means that if you have a mortgage on a house and if you sell the house, instead of the buyer having to go out and find his/her own mortgage, the buyer can just take over the payments on your own mortgage. In other words, the mortgage can just transfer to the buyer. This is advantageous to the buyer if the existing mortgage has better terms (i.e., a better interest rate) than new mortgages. It is also advantageous to the seller in that it may make the house more likely to sell. As a buyer, you shouldn't expect to just pick up the payments. Most likely, the seller will want you to pay him/her for the equity he/she has in the house and then pick up the payments.

d) Owner-financed mortgage. The seller of a house (i.e., the owner) can loan the buyer the money for the house. In actuality, the seller doesn't actually loan the buyer money. Rather, the seller just takes on the role of the mortgage company lets the buyer pay him/her the equivalent of a downpayment and monthly mortgage payments. There are several advantages to the seller. As you'll see in topic 11 (Pay Off Your House), when you buy a house, you typically pay a tremendous amount of money in interest over the life of the loan. All that money will go to the seller in an owner-financed mortgage. The other advantage is that it may enable a person who wouldn't normally be able to qualify for a mortgage to be able to buy the house (such as someone with bad credit). The disadvantage of this type of loan is that the seller assumes all the risk. The seller is possibly going to be in this arrangement with the buyer for 30 years. If they buyer stops paying on the loan, then the seller has to go to court to foreclose on the house. A seller has to be ruthless in these situations because it may mean throwing a family out on the streets. If you're not that type of person, don't be an "owner financer."

e) Reverse mortgage. This is not really a mortgage at all. A mortgage is a loan to enable you to buy a house. A reverse mortgage is an arrangement used in rare situations by retired people (for instance). Suppose a person has reached retirement but has never really saved any money for retirement. But suppose that same person has paid off their house. Well, the person has all their money tied up in their house and now their going to starve to death. Rather than sell the house just to get money for food, the person can take out a reverse mortgage. The person gives the "deed" to their house to a bank and the bank gives them an amount of money in return (as if they sold the house to the bank) but the bank lets the person continue to live in the house until death. Upon the person's death, the bank sells the house and gets their money back. For example, suppose you have a $200,000 house. The bank may give you a reverse mortgage for 75% of the appraised value or $150,000 (remember, the bank won't give you the full value of the house because the bank needs to make sure that the house will sell for more than the value of the reverse mortgage when you die). You live on the $150,000 for the next 20 years. When you die, the bank sells your house to recover their money.

The moral of the story: Get a fixed rate mortgage, preferably for 15 years.

7. Refinance a Home

Sometimes people don't like something about their current mortgage and they decide they want to "refinance their home." To refinance means to get a new mortgage and use the money from that mortgage to pay off the previous mortgage.

There are many reasons why someone may want to refinance:

a) Get a better interest rate. Sometimes, when the economy changes, interest rates drop. For instance, when we first bought the house in Friendswood (1992), we got a 30 year fixed rate mortgage at 7.875% interest. Our principal and interest payment was $580 per month. In 2002, we decided to refinance because we could get a 30 year fixed rate mortgage at 6.625% interest (a reduction of 1.5%). Our new payment was $396 per month. The closing costs to refinance (the paperwork and other expenses charged by Wells Fargo) were only $600 so you can see it only took 4 months to break even (saving $180 per month paid for itself in only 4 months). The only downside to refinancing is that you start with a brand new loan. So, we were in the 10th year of a 30 year mortgage (only 20 years until it's paid off) and then we started with a new mortgage with 30 years to go until it's paid off..

b) Shorten the mortgage. A person might want to change a 30 year mortgage to a 15 year (if they have extra money in the budget and don't mind paying a higher monthly payment but pay the loan off earlier).

c) Lengthen the mortgage. If a person has a very tight budget, he/she might want to change a 15 year mortgage to a 30 year. It will reduce the monthly payment but will take longer to pay off. This is very rare.

d) Debt consolidation. Suppose you had a $100,000 mortgage at 6% on a house worth $160,000. And suppose you had been very irresponsible and run up $20,000 in credit card debt at 15%. Conventional wisdom might say to consolidate the $120,000 in debt in a single new mortgage. This should greatly reduce the interest rate being paid on the credit card debt. There's one disadvantage to doing this. Do you see what it is? Remember that credit card debt is unsecured (not covered by collateral). When you combine your credit card debt with your mortgage you just "collateralized" or "securitized" that debt. In other words, you took a debt that had no collateral and now you have made your house the collateral for that debt. Never securitize unsecured debt. The best way to avoid this situation is never to accrue the credit card debt in the first place.

8. Guidelines for Lodging Expense.

Here is some guidance regarding the maximum amount of money you should borrow when buying a house or the maximum amount of rent you should pay to rent a house or apartment.

Never buy a house, rent a house or rent an apartment if your monthly payment will be more than 25% of your gross monthly income and no more than 33% of your net monthly income. This guidance assumes you have no debt. If you have other debt, these amounts go down.

Now for a few definitions.

<u>Gross Monthly Income</u>: Your monthly salary before taxes and benefits are deducted. It can be calculated as

Gross Monthly Income = (Annual Salary) / 12

For example: If your annual salary is $36,000, your gross monthly income is $3000 ($36,000 / 12).

<u>Net Monthly Income</u>: Your monthly salary after taxes and benefits are deducted. Also called your "take home pay" (what you actually take home in a paycheck).

Assuming you get paid once per week, it can be calculated as:

Net Monthly Income = (Amount of paycheck) * 52 / 12

Assuming you get paid every two weeks, it can be calculated as:

Net Monthly Income = (Amount of paycheck) * 26 / 12

Remember, "Amount of paycheck" in the calculations above is the actual net pay that you get paid each pay period after taxes and all deductions (i.e., the amount of your paper pay check or the amount that gets direct-deposited at the bank).

For example, let's assume that your annual salary is $36,000, and you get paid weekly. That would be a gross weekly income of $692.31 ($36,000 per year divided by 52 weeks). If we assume that taxes and deductions eat up about 20% of your paycheck, then the amount of your paycheck each week after taxes and deductions is about $550.00. Your net monthly income would then be about $2400.

Now, let's use these hypothetical numbers (Gross Monthly Income = $3000, Net Monthly Income = $2400) and calculate what size apartment or house we could afford.

25% of Gross Monthly Income = 25% * $3000 = $750.
33% of Net Monthly Income = 33% * $2400 = $792

So, given the guidance above, and assuming the gross and net pay amounts above, then you should not rent an apartment or house if the payment is going to be more than $750 per month. Nor should you buy a house if the mortgage payment including "escrow" is going to be more than $750 per month.

Now for one more definition:

<u>Escrow</u>: Escrow means money held by a third party on your behalf. There are two major expenses incurred by all homeowners: Property Tax and Insurance. Property tax for our house in Friendswood was about $3600 per year. Insurance was about $2100 per year. As a courtesy, mortgage companies used to allow their customers to send their property tax and insurance payments in with their monthly mortgage payments and the mortgage company would pay the property tax and insurance bills when they were due. As an example, our mortgage payment for the Friendswood house (principal and interest) was $396. But the monthly average for property tax was $300 and for insurance was $175. Some mortgage companies (especially 10 years ago), would bill the customer every month for principal and interest and for insurance and property tax. In the example above, the monthly "mortgage payment" would be $871 ($396 plus $300 plus $175). The advantage to the mortgage companies was they got to hold your money "in escrow" which meant they could invest it if they wanted. The disadvantage to the customer is, "What happens to that money if the mortgage company goes bankrupt?" But most mortgage companies don't collect the insurance and tax money any more.

The moral of the story: When determining what size house you can afford, don't forget to factor the property taxes and cost of insurance into your calculations.

9. Avoid Credit Cards.

This is the related to #2 and #3 above, but I wanted to talk about it separately. As I said above, a credit card is just unsecured debt (there is no collateral to protect the lender). You are on your honor to pay the debt and if you don't you can get sued. But if you have no money, the credit card company will not be able to do much to you. That's why the interest rates are so high, because the bank is assuming all the risk.

You should avoid the use of a credit card unless you are extremely disciplined and pay the entire amount owed every month. I'm extremely disciplined and pay off my credit card in full every month. I've had a card since I got out of college and I've paid it in full every month with one exception. One month, I forgot to pay the bill. If you are not this disciplined, you should not have a credit card. Credit cards and people's inability to use them wisely have messed up countless lives, countless marriages, countless families. People commit suicide because they can't get a grip on their use of credit cards (or other forms of debt). I know a man that committed suicide because he got so deep in debt, he couldn't figure out how he could ever get out. Abuse of credit cards can ruin marriages, families, etc.

I justified the use of a credit card when I was your age because 1) I wanted it in case of an emergency (this was before the existence of debit cards) and 2) I knew I would pay it in full every month. With the advent of debit cards, it's much better just to pay for things as you go because then it's much more difficult to lose control
There's one more reason I'd recommend against the use of a credit card. It's a proven fact that when people use a credit card they spend more than when they use a debit card. It's easy to overspend when you're putting it on the card because you lose track of what your card balance is.

Moral of the story: Avoid credit cards.

10. Use Debit Cards.

A debit card is the same as cash. Plus if you read the fine print on your debit card, it has the same protection as a credit card regarding fraud. I used to like to use the credit card because if someone ripped me off (whether they stole my card number and purchased something fraudulently or they just sold me junk goods), I would have the opportunity to not pay the credit card bill until the issue was resolved. But the reality is that the credit card companies refund any money that you may have paid on a fraudulent charge. Debit cards do the same. So using a debit card is no more risky than a credit card, even though your money may leave your account instantly with a debit card. Plus, no one ever overspent using a debit card. If you don't have the money, you can't buy it.

Moral of the story: Pay as you go. Use a debit card.

11. Buying a House.

There are several reasons to buy a house:

a) A house is one of the few assets that you buy which will appreciate (increase) in value over time. Almost everything else (car, boat motorcycle, furniture, appliances, etc.) depreciate (decrease) in value over time. Houses don't always appreciate in value, but they usually do.

b) Interest paid on a mortgage (a house loan) is tax-deductible. Just getting the tax deduction is not reason enough to buy a house or take out a loan on a house, but if you're buying one, it does reduce the overall income tax you will pay, so it's like getting some money back.

c) The amount you pay on your property taxes is tax-deductible on your income tax.

d) Often times, the mortgage payment on a house each month may be comparable to the amount you'd pay for rent, so many times, buying a house makes good sense.

e) Gives your children a place to grow up which is nicer and safer than an apartment.

f) Gives your children more stability. If you rent, you may be forced to move frequently (most leases on houses are only good for 12 – 24 months). That means changing schools, getting different friends, etc.

There are several reasons not to buy a house:

a) If you're not planning to live in the area for an extended period of time, don't buy a house. There are a lot of costs associated with buying and selling a house. You don't want to pay those costs frequently. For instance, Mom and I may only live in San Antonio for 6 years before we move to Ingram. So it may make more since to rent rather than buy and then have to sell in six years.

b) One of the primary concerns when you buy a house is to get a quality house so you'll be able to get at least what you paid for it when it comes time to sell. A house is the largest investment you will probably ever make, so if you can't afford to get a quality house, then you should wait until you can afford it. The only exception to this guidance might be if you never plan to sell the house (i.e., you plan to live in it until you die). But even then, wouldn't you like your heirs to be able to sell the house after you're gone for a good price. More on this below in the section "Houses to stay away from."

c) If you're in debt already, it's probably not a good idea to buy a house. The best situation is to not have any debt except for your house. Otherwise, you have too much money going out the door each month to other people. Rent until you get out of debt.

d) When you own a house, you have expenses in addition to your mortgage payment. Examples are payment of property taxes, purchase of insurance (regular homeowners insurance, windstorm insurance in the event of a hurricane and flood insurance), repairs and maintenance. If you can't do most of your own repairs and maintenance, that can get very expensive. If you are on a tight budget, these additional expenses can break the budget.

Houses to stay away from:

a) Low quality house. For example, one of the most important considerations when buying a house is the condition of the school district. If the only house you can afford to buy is not in a good school district, then it may be hard to sell later for a good price. Another concern is location. Buying a house near railroad tracks or an airport can be a disaster. People don't like being awakened by trains or planes. Another concern is the neighboring houses. If the house you're buying is the nicest house in the neighborhood and all the other houses look bad (either poor quality or ugly yards), then you'll likely not get as much money as you expect when the time comes to sell.

b) Mobile homes. Mobile homes never appreciate in value, so if you buy a mobile home, expect to lose money on it. In recent years, mobile homes have started going by a new name: manufactured homes. So be aware.

c) Manufactured homes. Originally, the term manufactured home denoted a house like those made by Jim Walters Homes. That is, it denoted a prefab (pre-fabricated) house which meant that all the materials were manufactured and cut to size in advance. The entire house is shipped in boxes and you just assemble it on your foundation when it arrives. Though much better quality than a mobile home, manufactured homes also tend to depreciate in value.

Keep in mind that the highest quality homes are brick homes on concrete foundations. Houses built on blocks or houses with wood siding or plastic siding (Hardee board, etc.) are cheaper to build and thus lower in quality. For instance, our house in Friendswood was half brick and half siding on a concrete foundation, so it was of reasonable quality and appreciated in value reasonably over the time we lived in it.

Also keep in mind, that if you own a house and you want to make improvements think about whether the improvement will increase the marketability of your house or not. For instance, replacing wood floors with carpet increases the market value of your house. Although you may spend $3000 putting in the floors and you may not increase the value of your house by $3000, your house will look much better nonetheless. Doing something like adding a porch or a deck in the back is also usually a good investment (gives the house a lot of appeal when it comes time to sell). Adding a room onto a house is usually a bad investment. It costs a lot of money but you usually don't increase the value of your house by a significant amount. Or you end up making your house the largest house in the neighborhood and can never recover the amount of money spent when you sell. And if you add onto your house, such as building a porch or a deck, do a quality job. You don't want to have a beautiful house with an ugly porch or deck. It will hurt you when it comes time to sell. If you're going to do it, do it right.

12. Pay Off Your House

When you buy a house, don't plan on keeping your mortgage forever. Make plans and live to pay off your mortgage early. Very few people in America ever pay off their house, but when you retire, you don't want to have a mortgage payment. That is money that is just flying out the door every month. If you do the math, you'll see that having debt just doesn't make sense mathematically. That's true for having a mortgage also. That's why you should plan to pay off your mortgage early.

Here's an example: Supposed you got a 30 year fixed rate mortgage for $150,000 at an interest rate of 6.0%. Your monthly principal and interest (P&I) payment would be $899.33. At the end of 30 years, when you have paid off your mortgage, you would have paid $150,000 in principal (of course) and $173,755 in interest. In other words, your $150,000 mortgage actually cost you $323,755 (360 payments of $899.33 each). Suppose you got the same $150,000 mortgage at an interest rate of 6.0% but only for 15 years. Your monthly P&I payment would be $1,265.79. But at the end of the 15 years, you would have paid $150,000 in principal but only $77,841 in interest for a total of $227,841. Thus, the difference between a 15 year and a 30 year fixed rate mortgage is $323,755 - $227,841 = $95,914. Now wouldn't you rather have that $95,000 rather than giving it to your mortgage company. That demonstrates the difference between a 30 year mortgage and a 15 year mortgage.

But you could just as easily get the 30 year mortgage but pay extra every month. That has the same effect has having a shorter term mortgage. Let me explain how the bank calculates how much of your payment goes to interest (payment for privilege of borrowing the money) and how much goes to principal (payment to reduce the size of the debt) each month. Let's take the 30 year mortgage above as an example. The monthly payment is $899.33. For the first payment you make exactly $750.00 goes to interest. Everything over the interest payment goes to principal (in this case $899.33 - $750.00 = $149.33). The interest payment of $750.00 is calculated as follows:

$$\text{Interest Payment} = \frac{(\text{Amount Owed}) * (\text{Annual Interest Rate})}{(\text{Number of Months in Year})}$$

or

$$\text{Interest Payment} = \frac{(\$150{,}000) * (6.0\%)}{(12)} = \frac{\$150{,}000 * 0.006}{12} = \$750.00$$

The next month, you only owe $149,850.67 ($150,000 – $149.33), so the interest payment will be slightly less. Using the calculation above, for your second payment of $899.33, the interest payment is $749.25 and the principal payment is everything else ($899.33 - $749.25 = $150.08). This process continues every month. After 10 years of paying (one third of the life of the loan), you have only paid off only $24,472 (or approximately one sixth of the value of the loan). After 15 years of paying (half of the life of the loan), you have paid off only $43,428 (less than one third of the value of the loan). The reason is because such an enormous amount of the payments in the beginning of the loan go to pay interest.

If you notice, above I said “everything over the interest payment goes to principal.” What if you paid extra every month. Then every single penny of the extra amount you pay goes to principal!!! This is what is known as “prepaying” your mortgage or paying your mortgage off early.

Let’s look at the 30 year mortgage above one more time. Remember, if we pay $899.33 each month, we’ll pay off the mortgage in 360 months (30 years). If you just add $100.00 each month to your payment, you’ll pay the mortgage off in 279 months (or just over 23 years or about 7 years early). You would’ve paid a total of $127,867 in interest instead of $173,755 for a savings of almost $46,000!!! If you pay an extra $200.00 each month, you’ll pay the mortgage off in 230 months (or just over 19 years or about 11 years early).

Hopefully, it’s easy to see the advantage of prepaying on your mortgage every month.

There are just a couple of things to be aware of when prepaying your mortgage. Some mortgages have fine print that the mortgage can’t be paid off early without paying a penalty. When you are originating your mortgage, make sure you ask the lender about prepayment penalties. Make sure it’s in writing in your mortgage contract that there is no penalty for early payment. The other thing to be aware of is a small scam perpetrated by mortgage companies. Some mortgage companies will advertise a plan to pay off your mortgage early. The plan goes something like this. Take your monthly mortgage payment and divide it by two. Send that amount to the mortgage company every two weeks. That has the effect of making 26 “half-payments” per year, or 13 monthly payments which is the equivalent of making one extra payment every year. There’s nothing wrong with that and it does work as expected. The scam is that the mortgage company will charge a fee to set you up to do this. You can do the same thing yourself, as shown above, by just paying extra any time you want.

So why get a 15 year mortgage instead of just paying extra every month on a 30 year mortgage? The only reason is that you usually get a lower interest rate for a fixed rate 15 year mortgage.

There are some people that think paying off your mortgage early is a bad idea because interest on a mortgage is tax deductible, and if you pay your mortgage off, you lose the tax deduction. Let’s take an example and do some math to prove that paying off the mortgage is a good idea. Income tax is calculated as a percent of your taxable income. You are assigned to a tax bracket based on how much taxable income you have. These are not real numbers but they should get the point across. People who make less than $8,000 per year are in the 0% tax bracket meaning that they pay 0% of their income in tax. People who make less than $20,000 per year are in the 11% tax bracket, meaning that they pay 11% of their income in tax. Let’s say that you are in the 25% tax bracket. That means for every dollar you make you pay 25 cents in income tax. A tax deduction is money that is subtracted (deducted) from your income before your calculate your income tax. Let’s say you pay $10,000 in interest on your mortgage this year. Just as 25 cents of every dollar you earn goes to pay income tax, every dollar you can deduct from your income will reduce your tax bill by 25 cents. That means, that if you have $10,000 in tax deductible interest, then you will save $2,500 in income tax. Now, if you paid the mortgage company $10,000 in interest, but the Uncle Sam (the US government) let you keep $2,500 in taxes, then you really only lost $7,500. But what if you had paid your mortgage off early and as a result you lost the income tax deduction? Then you would've paid nothing to the mortgage company, but you would have owed $2,500 to Uncle Sam. So you would've actually only lost $2,500 rather than $7,500. So it's easy to see that it's better to not have a mortgage and pay the extra income tax rather than pay all the interest just to get the deduction.

I have Excel spread sheets that you can use to do all these calculations if you want to run some examples yourself.

The moral of the story: Pay your mortgage off as fast as you can. You will save tens of thousands of dollars in interest.

13. Buying a Car.

New cars depreciate (lose value) rapidly in the first few years. I've heard something like a new car loses 10% of its value when you drive it off the lot and loses 60% of its value in the first four years. So, I will never buy a new car again.

A car, like so many other things, is not a good investment. An investment is something that increases in value. A car always loses value. Your goal in buying a car is to buy something that will depreciate (lose value) as slowly as possible. The best way to ensure that is to buy a used car. Buying a car that is 1-2 years old with "low" miles is a good way to go. You'll probably be able to buy the car for about 25% - 30% less than a similar new car. Since I do a lot of my own automotive work, I'm not afraid to buy a 6 – 7 year old used car but that may not be what you want to do.

Regardless, you should not go into debt to buy a car. If you can't pay cash for a used car that is only 1 year old, then buy the car you can afford to buy with cash. Too many people in our society have grown accustomed to a car note (a car loan) to the extent that they can't imagine life without a car loan. They either buy a new car and get a new loan before they pay off the old loan (and just roll the balance into the new loan) or the day they pay off their car, they see that as an invitation to go buy a new one and jump right into debt.

As you know, your mother and I paid cash for the cars that we gave you when you turned 16. We decided long before that that's what we wanted to do so we budgeted and saved to make it a reality. I'll never forget a conversation I had with my mom when Marie was a senior in college and Matthew had just started driving his Acura. My mom said, "I don't envy you with all those car notes." After all, we had six cars and she couldn't comprehend that we could have paid cash for all of them. I explained to her that I had paid cash for all of them and had no car note and never planned to get a car note. She was shocked. Like I say, for some people, a car note is a way of life.

Occasionally, you'll see car dealers advertise 0% interest for 48 months (or something like that). That just means that they're going to take the sales price of the car, divide it by 48 and that's your monthly payment. It sounds like a great deal, right? After all, you're not paying any interest so you can invest the money somewhere and make money while you make your monthly payments. The downside to this deal is the fine print in the contract. I haven't seen the fine print, but the rumor is that the fine print says that if you are ever late on a payment (even one day late), then you get charged a penalty and interest, supposedly retroactive to the first month of the contract. It's not such a good deal if you make one mistake and get punished for four years. Always read the fine print.

Keep in mind that some cars have better resale value than others. That is, the depreciate more slowly than other cars. For instance, Toyotas and Hondas traditionally have been more reliable and have better resale value than their American-made counterparts.

One last thought. Never lease a car. Leasing anything is usually a bad idea. Leasing a house can be a good idea for reasons identified above. But when you lease a car, you pay a pretty high monthly lease payment, similar to what a car note would cost you, but at the end of the lease period, you don't have anything to show for your money. Even if you buy a car that depreciates quickly, after four years, you can still sell the car and get several thousand dollars for it. With a lease, you turn the car in and have nothing to show for it.

14. Credit Score

Everyone has a credit score. The most common method for evaluating an individual's credit risk / creditworthiness is via their FICO score. FICO is named after the Fair Isaac Corporation. Fair Isaac came up with a formula for calculating an individual's creditworthiness. It is a well kept secret as to exactly what the formula is. Suffice it to say, it is based on a bunch of criteria such as: 1) How much debt you have, 2) How responsible you are to pay your payments, 3) How frequently you go into debt, 4) How frequently you pay off debt early, etc. But much of it doesn't make sense. For instance, having some credit cards is good for your FICO score, but having too many credit cards is bad. Just having a lot of companies inquiring about your credit score (i.e., companies running credit reports on you) is bad for you score. Missing a debt payment is very bad for your score, as you might imagine. But paying off debt early is also bad. If you never borrow money, you will have a FICO score of zero. You might think that is good. But many companies think that is bad because you have no documented history of being able to pay off debt. I'm not positive but I think a credit score of at least 700 is good and a score of around 850 is just about the highest you can get.

There are three major credit agencies in the US: Equifax, Experian, and Trans Union. By law, each agency must divulge your credit report to you once per year upon request for free. The best method for requesting your free credit report is through http://www.annualcreditreport.com. A company called freecreditreport.com advertises a lot on the radio, but don't use them as they are not completely free (you must agree to try some product for 90 days). Annualcreditreport.com is the real free site. When you request your credit report, you will not get your FICO score. But you will get a list of every company with whom you are currently in debt and every company with whom you were in debt in recent history. That is, you'll see your mortgage company, your credit card companies, the company that financed your car and information about your payment history (i.e., do your make your payments on time or have you ever been late on a payment). You will also see information about debts you have paid off and accounts you have closed (such as credit card accounts that you have closed).

You should not worship at the altar of the FICO score. Here is a sound philosophy. If you are living your life as described in this paper: Avoid all debt except a home mortgage (don't borrow to buy a car, don't use credit cards, only use debit cards), then you can guarantee that you'll have a very low FICO score. But is that so bad? You might ask, can I qualify for a home mortgage with a low FICO score? My answer is yes, if it's low for the right reasons. Some mortgage companies don't look at anything but the score and they will not qualify you for a mortgage. But you want to find a mortgage company that will look at the reason for your low score (i.e., you want a mortgage company that will use their brain). If you've been renting for a while, then you have proof that you are responsible to make monthly payments. You'll need to provide that evidence and then explain your financial philosophy to the mortgage company. If you explain that you have a low FICO score because you don't like to go into debt, but you like to hoard cash, and you have a history of paying rent on time, and you have a down payment of reasonable size, and you will have a reasonable monthly payment (remember, your monthly payment is less than 25% if your gross pay and less than 33% of your net pay), then a mortgage company that uses their brain will realize that you are the best credit risk of all and will love to do business with you.

Do not believe the lie that you can't survive without credit or that you can't survive without a high FICO score. Trying to chase a FICO score is just the act of going into a little debt so that you are qualified to go into more debt. Turn the tables. If you stay out of debt from the beginning, you'll never need debt to finance your life or to have the nice things in life.

There is only one reason to have a high FICO score, but for me, this reason does not justify the need to go into debt. When you buy certain kinds of insurance, such as life insurance or auto insurance, people with good credit ratings get a better price than people who don't. That is because many of the insurance products are paid with monthly premiums and the insurance company is interested in your history of paying monthly payments on time.

And please remember, there is a difference between having bad credit and having a low FICO score. "Bad credit" means that something in your past indicates that you are high risk, such as having been late on payments or having defaulted on a credit card. A low FICO score means you have bad credit or you just have not gone into debt in a long time if ever. Many financial institutions try to equate a low FICO score with bad credit. It will be up to you, when you buy a house for instance, to explain the difference and explain why having a low FICO score can be a good thing.

The moral of the story: Don't do stupid things to get a good FICO score. Avoiding debt is the best thing that you can do.

15. Saving / Investing.

You need to save as much money as possible over the course of your life. But you need to "save" money on at least three levels:

a) Tithe. The first 10% of every paycheck is God's. Without getting into the theology, suffice it to say that God gives you all the money you ever receive, so the first 10% is to be given back to Him. If you must, take 10% out of your paycheck the day you get paid and put it in a separate account if that's what it takes to keep you from spending it. Then write a check for that amount at church on Sunday.

b) Retirement Savings: You should save money for retirement at least once per month. It's easier to do if you set the money aside every week. Until about 10 years ago, most major corporations provided a pension for all employees. The pension (also called a defined benefit pension) would pay an employee a fixed amount of money every month after retirement until the day they died. With a pension and Social Security, most people didn't need anything else to make ends meet in retirement. Bear, Aline, Nanny and Paw Paw each have a very nice pension from their previous employers. Each of them worked for the same company for their entire working lives and so each of their pensions is very lucrative. About 20 years ago, people started job-hopping and it became less common for someone to work for the same company all their life. Look at me. I've worked for four different companies, but only the last two (USA and Lockheed Martin) offered a pension. I was with USA for 10 years and was with LM for 12 years before they suspended the pension. So I'll get a small amount from each company in retirement, but I have to produce some of my own savings or your mother and I will not survive. The government has passed laws in the last 25 – 30 years to set up some fabulous vehicles for individuals to save for retirement. These vehicles are the 401(k) plan, the 403(b) plan, the 457 plan, the Traditional IRA (Individual Retirement Account), and the Roth IRA. Your generation will likely never receive a pension, so you must save for yourself. Saving while you're young gives you the extra benefit of time, lots of it, for your savings to compound and grow.

   i. 401(k): The most common type of retirement savings plan offered by businesses. The 401(k) is named after the paragraph of the Internal Revenue Code that defines the plan (i.e., section 401(k) of the Internal Revenue Code). Most corporations offer a 401(k) to employees and will match some amount of the money saved by employees. My last three employers offered a 401(k) and I participated in each one. Most plans work like this: You can contribute anywhere from 1% - 25% of your salary to the plan. The money contributed is not taxed until you withdraw it. Since the money is not taxed until you withdraw it, it grows tax free until your retire. So you reduce your taxes now, and since most people earn less in retirement than they do when they're working, most people are in a lower tax bracket when they retire. The maximum that you can contribute to a 401(k) can change each year, but it is currently set at $16,500 per year. This is a great way to accumulate wealth for retirement! I'll talk more about 401(k)'s below.

ii. 403(b): Similar to a 401(k), but it's only valid for the employees of charities. For instance, Memorial Hermann Hospital was actually a charity hospital so employees were offered to participate in a 403(b), not a 401(k). The 403(b) has the same maximums as and works almost identically to a 401(k).

iii. 457: Similar to a 401(k), but it's offered to government employees. I think Marie was offered a 457 plan when she was a teacher for the state of Texas. The 457 has the same maximums as and works almost identically to a 401(k).

iv. Traditional IRA: Similar to a 401(k) but it's not offered by employers. It's offered by banks and financial institutions to individuals. It's primarily what is available to each person whose employer doesn't offer a 401(k), 403(b) or 457 plan. The maximum you can contribute to a traditional IRA can change each year, but it is currently set at $5000 per year. If you are offered a 401(k), 403(b) or 457 plan at work, you generally are not allowed to contribute to a traditional IRA.

v. Roth IRA: Named after the Congressman that sponsored the legislation, the Roth IRA is similar to the traditional IRA except for the following: The contributions to the Roth IRA are taxed in the year that the contribution is made, but the money that the Roth IRA earns is never taxed. In other words, you pay income tax on the money you contribute in the year it is contributed but you never pay income tax when the money is withdrawn! What a deal for someone who is young! Pay a little now and never have to pay again!

Some important things to know about the pre-tax plans (i.e., 401(k)'s, 403(b)'s, 457's and Traditional IRA's):

i. In general, the money can not be withdrawn until age 59.5. There are a few exceptions such as the purchase of your first home, to pay for college expenses for a child, and in case of hardship. If the money is withdrawn for a reason other than one of the approved exceptions, the money is taxed at current rates and you pay a 10% penalty. If you contribute to one of these plans, you should do so with the intention that you will not touch the money until you are 59.5. After all, you are saving this money for retirement. If you start using it for other purposes, you're just not going to be able to retire at the age you want.

ii. Once you reach age 59.5, you may begin withdrawing the money, but it is not required to withdraw anything until age 70.5. Once you reach age 70.5, you must begin making withdrawals (the government wants you start paying some taxes). Bear, Nanny and Paw Paw never made a withdrawal until age 70.5, because they had such good pensions from their employers, they didn't need the money.

iii. Almost every employer that offers a pre-tax plan will match some portion of your contribution. For instance, Lockheed Martin will match 50 cents of each dollar I contribute to my 401(k) up to the first 8% of my salary that I contribute. In other words, if I contribute 4% of my pay each week, LM will contribute 2%. If I contribute 8%, LM will contribute 4%. If I go higher than 8%, then LM will still just contribute 4%. BUT THAT IS FREE MONEY!!!

iv. Mom and I each contribute the maximum allowed by law (i.e., $16,500 per year each).

v. My guidance is as follows: You should contribute at least as much as it takes to get the full company match. In my case, I should always at least contribute 8% because then I get the maximum company match of 4%. If you can't afford to contribute that much, then start small and work up to that amount. For example, when I was 24 years old, 401(k)'s came into existence. I wasn't making much money and I was scared to commit my money to a savings vehicle that I couldn't touch until I was 59.5 years old. So I only contributed 2% that first year. But I set a goal that I would increase my contribution in 1% increments every year until I reached 10%. The second year I gave 3%, the third year I gave 4%, until in the 5th year I was giving 6%. By the 6th year, I was seeing the amount in my account grow so large that I got inspired and just jumped straight to 10% in year 6. I also created a spread sheet and calculated what my contribution could grow to if I gave 10% every year until retirement taking into consideration realistic pay raises that I might receive each year and I was a believer. I have never regretted jumping in. I have only regretted not doing so sooner. Create a spread sheet for yourself and use realistic numbers and see how much money you can have in 30 – 40 years. You will be amazed.

vi. The pre-tax plans are good as long as you're working for the company. If you ever quit the company, you usually have three options. One option is to leave the money in your previous company's 401(k). Another option is to "roll" the old 401(k) into your 401(k) with your new employer. A third option, which is the one I recommend, is to "roll" the old 401(k) into an IRA. An IRA gives you much more flexibility than a 401(k) so whenever you have a chance to move your money, you should do so. But the only time you can usually move your money is when you quit your job. The reason that the IRA is preferable is because of the investment options available to you. Your company 401(k) probably only gives you about 10-15 options for investment (usually one money market fund, a couple of bond mutual funds, and about 10 common stock mutual funds). But an IRA will allow you to invest in any money market, any mutual fund (stock or bond) or any single stock in the world.

vii. If you ever perform a "rollover" as described above, be careful how you do the rollover. You as an individual should never take possession of the money. If you do, by law, the company has to withhold 20% of the money and send it to the IRS for income taxes. You then have to deposit all of the money (including come up with the 20% that was withheld) it into the rollover account (i..e. the IRA or the new 401(k)) within 60 days, or the entire amount gets treated as a withdrawal and you have to pay the income taxes and the 10% penalty. Rather than go through all of this mess and risk messing it up, just do a "trustee-to-trustee" rollover. The bank that holds your 401(k) is a trustee. The bank that will hold your IRA or new 401(k) is also a trustee. You just talk to both institutions and give them the instructions in writing that you want to close one account, open a new account and fund the new account with the money in the old account and the two financial institutions will make the transfer without you ever touching the money. Financial institutions do this type of transfer to keep you from messing up and getting yourself in tax trouble.

viii. The 401(k) plans have one other appealing feature, though it's a feature that is dangerous to use. Most employers will let you borrow from your 401(k). Sometime people use a 401(k) loan to buy a car, buy a house, or something else they want. There's no penalty for doing so. It's your money and you end up paying the interest back to yourself. The problem with a 401(k) loan is if you ever quit your job or get laid off, the balance of the loan is due immediately and if you can't pay it back in full at that moment, then it's treated like a withdrawal. You get charged with the income taxes and the 10% penalty.

Some important things to know about Roth IRA's. When you are young, participating in a Roth IRA can be the smartest thing you ever do. If you create a spread sheet and calculate saving money over a 40 year period and then calculate how much money that money will earn if you make something like 8-10% on your money, you'll quickly see that you make more than you contribute. So, with a Roth IRA, you'll be taxed only on what you contribute and then all the money you make in your investments is never taxed. So, the younger you are when you start the better the Roth IRA is for you. At my age, a Roth IRA is OK, but I won't be invested long enough for the money to earn a lot of money. You will. One last thing. Lockheed Martin just started offering what they call a Roth 401(k). It has all the contribution rules and options of a traditional 401(k) but all the tax advantages of a Roth IRA. If your job offers a Roth 401(k), it is probably the best investment you could ever make while you are young. The Roth IRA and Roth 401(k) are so lucrative that Congress may end up repealing them one day!

c. Short Term Savings: After setting aside 10% for the tithe and another amount for retirement savings, you need to set aside an amount for short term (post tax) savings. In a perfect situation, you should set aside 10% for the tithe, 10% for retirement and 10% for short term post tax savings. Set a goal for the short term savings. Perhaps you are saving for your next car? Or for a house? Or a new TV? But set a goal. That is how you never go into debt – you save for years in advance of buying your large purchases. When I say set the money aside for short term savings, I mean get it out of your checking account. If necessary, open several savings accounts or several money market accounts, one for each large purchase you want to save for. Get the money out of your checking account so it's not tempting to spend on other things.

You can save money for short term savings one of two ways. The first is the way described above – identify a percentage amount and move that money to a different account every week. Another way is what I did when I was younger. I found that my checking account fluctuated week to week based on the bills I paid and the paychecks getting direct deposited into my account. But I found that if I kept $1500 in my checking account, I never really had to worry about my balance getting too low. So what I did was I picked a certain day every month (for me I picked the last day of the month) and on that day, I would write a check to take my checkbook balance down to $1500 and sent that check off to a money market fund. In other words, on the last day of the month, if I had $2100 in my checking account, I would write a check for $600 and put it in a savings account. If I had $1700 in my checking account, I would write a check for $200 and put it in savings. That wasn't as rigid as setting a fixed percentage every month but I just about saved something every month.

Moral of the story: Save as much as you can for retirement in a Roth account first (Roth IRA or Roth 401(k). Once that is exhausted save as much as you can for retirement in a pretax plan (a traditional IRA or 401(k)). You'll be shocked at how much you accumulate. Also, save some money every month on a post-tax basis for short term goals and long term goals.

16. Investments

There are several different investment vehicles available to you. Basically, some investments are low risk (not much chance of losing money) and some are high risk (higher chance of losing money). But if you are willing to take some risk, then there's greater potential for reward (i.e., higher return).

Some of the most popular investments are:

a. Savings account: Available at your neighborhood bank. Very liquid (meaning you can put money in and take it out on a daily basis with no problem). Pays a very small interest rate. Right now, the amount of interest is trivial (only about 0.25 – 0.50%). The reason interest rates are so low is because inflation has been very low for the last decade or so plus we have just gone through a lending crisis in the last two years. So the federal reserve bank is lending money to banks at a rate just above zero so that when the banks loan the same money to people like you and me, everything they get is almost pure profit (and that should help them return to good fiscal health sooner). Savings accounts are very low risk and most accounts are insured by the FDIC (Federal Deposit Insurance Corporation).

b. Certificate of Deposit (CD): Available at every bank in the country. You give the bank an amount of money for a fixed period of time and the bank will give you a fixed interest rate. For example, Ally Bank is offering a 1.85% CD for 12 months. The interest rate is low (for the same reason that savings account interest rates are low) but they are low risk. Most CD's are insured by the FDIC.

c. Mutual Fund: An investment where you pay a fund manager to buy "securities" on one of the stock exchanges. The securities either go up in value or down in value based on several criteria. There are three primary types of mutual funds:

    i. Money Market Mutual Fund: Money market funds invest in cash investments, CD's, short term loans, etc. Every money market in the US strives to keep a "per share price" of $1.00. The money market pays a dividend which is then reinvested in the money market so it gives the appearance of paying interest. Money markets currently have a dividend yield of only about 1.0% which is analogous to 1.0% interest. Money market funds are not insured but no money market fund in the US has ever gone bankrupt. Nor has any money market fund in the US ever "broken the buck." That is, no money market fund in the US has ever dipped below the per share price of $1.00. In other words, they are basically no risk. Vanguard has some of the best money market funds in the US.

ii. Bond Mutual Fund: Bond funds invest in bonds. Bonds are an instrument used by corporations and governments to borrow money from individuals or other corporations. When a corporation or government issues a bond and you buy the bond, the corporation or government is promising to repay you your money plus interest at a future date. For example, Joe's Pizza might want to raise money to build some new stores. So Joe prints up some bonds and says, if you buy this bond for $90, I'll buy it back from you in three years for $100. That is the equivalent of earning $10 on a $90 investment in three years which is about the same as a 3% annualized return. So, if I buy the bond, I can hold it for three years and sell it back to Joe for $100. But what if I need some money before the three years are up? I can hold it for a period of time and then sell it to someone else. That someone else may pay me $92 for the bond, or $95 for the bond, or $98 for the bond. What that person will pay will be a function of how much interest that person can earn on an investment of the same money elsewhere. If interest rates on CD's are going up, then the other person will only pay an amount for the bond that will guarantee that he or she is going to make more on the bond than on a CD. If interest rates on CD's are going down, then I'll be able to sell the bond for a relatively high price since the buyer of the bond will still be able to exceed the yield of the CD. As a rule of thumb, when interest rates on savings accounts, CD's and money markets go up, prices on bonds go down (meaning that if you hold the bond already and try to sell it before the maturity date, you might lose money). A bond mutual fund buys groups of bonds under the direction of a "professional" manager. If you are not comfortable with buying individual bonds, you should invest in a bond mutual fund. There are a multitude of varieties in bond funds: Long term, short term, government, corporate, tax free municipal, etc.

iii. Stock Mutual Fund: Stock funds invest in the stock of corporations. In general, when a corporation's earnings are increasing, the corporation's stock price goes up. When a corporation's earnings are flat or decreasing, the corporation's stock price goes down. But a stock is only worth what someone is willing to pay for it. The US stock market can move wildly up and down based on any kind of news. If one big corporation reports declining earnings, the whole market can decline due to paranoia. If one big corporation reports increasing earnings, the whole market can increase due to euphoria. Since much of the stock market can be driven by emotion, it is dangerous to get into the stock market for short intervals. You should only get into the stock market if you are willing to stay in for up to five years. In other words, if you choose to invest a sum of money in the stock market, you should plan on leaving the money in the market for at least 5 years. If you are not comfortable with buying individual stocks, you should invest in a stock mutual fund. There are a multitude of varieties in stock funds: Growth, Aggressive Growth, Growth and Income, Income, Target, US, International, etc.

Here's a little more detail on what stocks are and how they work. Suppose I start a company named Joe's Pizza. At this point, I'm Joe and I own the company so the company is considered "privately held" meaning the company is owned by an individual. There is no stock. There are no stockholders. I, Joe, own it all. One day, I decide I want to sell the business, take my money and retire to Ingram. I can try to sell the business to another individual. Or I can decide to sell the business to the public. Let's say I have appraised the business and I think it's worth $100,000. I then print 10,000 shares of common stock. I plan to sell the shares for $10 per share so that I'll get my asking price of $100,000. This initial sale of shares in a company to the public is called an IPO (Initial Public Offering). There is an entire industry for pricing the shares for an IPO. Someone determines if $10 per share is a fair price or a ripoff. The public is surveyed, brokerage firms are surveyed, and finally a determination is made. Let's say that all the data that comes back indicates that the public is really only willing to pay $9 per share. That means the public believes the business is really only worth $90,000. I can choose to proceed with the IPO or stop the IPO and keep the business. Assume I decide to proceed, the day comes for the IPO and I sell all 10,000 of my shares at my asking price of $9. I take my $90,000 head for Ingram. Now, the public owns the company. Each person that bought a share of the stock owns a proportional interest in the profits of the company. The shareholders elect a CEO and the other executive management (in actuality, all those people are in place and the shareholders either vote to keep them or replace them) to run the company on behalf of the shareholders. This is now called a "publicly-held corporation" because the public owns the company rather than being owned by an individual. So, when the company earns profits, where does the money go? The executives of the company are entrusted to act in the best interests of the shareholders. So the CEO and his managers make the decision. The CEO can decide to keep all the profits in savings and stockpile cash. The CEO can decide to spend the money on "investments" such as buying other companies that will help increase profits. The CEO can decide to expand and use the money to build new Joe's Pizza restaurants. The CEO can decide to return the money to shareholders by paying a dividend on the stock. Or the CEO can decide to do some combination of all four: Pay a small dividend, go buy a competitor with some of the business, expand and build a couple of new restaurants and save the rest. Meanwhile every day, people are buying and selling shares of Joe's Pizza in the stock market. On the surface, that doesn't help the corporation at all, because the corporation has already sold all it's going to sell in the IPO. This daily trading is just moving the same shares back and forth between people. But one day, the CEO of Joe's Pizza decides it's time to go nationwide. He wants to build 500 new pizza restaurants. Well that takes cash and there's only a couple of ways to get that much cash. You either already have it on hand because you've been stockpiling cash year after year waiting for this moment, or you borrow the money from the bank, or you decide to print more shares of stock and sell them on the open market. A corporation can't just print shares of stock because it may hurt the base value of the shares already on the market (it's called diluting the value of the existing shares), so shareholders have to approve of the offering. But if the shareholders do approve, and if the share price has gone up significantly from the $9 that the shares sold for in the IPO, then the company and the CEO get a lot more money to use for the expansion. Hopefully, the expansion is successful and the company continues to make money and the stock continues to go up. Suppose the company expanded too fast and profits drop off a little bit (profits may have gone up but now there are more shares of stock, so the amount of profit attributed to each share of stock is smaller). People see the drop in profit per share and decide to sell the stock. More people want to sell than want to buy, so there is more supply than demand, so the share price starts falling. If the expansion was successful, and profit per share have gone up slightly, people notice that and start buying the stock. That creates more demand than supply which caused the price to go up. That's how the stock market works in a nutshell.

Moral of the story: There are a myriad of investments in the world. Huge books have been written on the topic. I can give you more information or you can read one of the many books on the topic.

17. Bankruptcy.

Companies go bankrupt and so do people. A company declares bankruptcy when it finally figures out that it can never make a profit given current conditions. That is usually due to debt that is out of control. The purpose of bankruptcy is to get rid of all the creditors (all the entities to whom you owe money). The two most common types of corporate bankruptcy are Chapter 7 and Chapter 11. In Chapter 7, the company goes out of business for good. All the assets of the corporation are sold, and the proceeds of the sale are given to the creditors. That is all the money the creditors will get. Creditors are anyone the corporation owes money to (such as suppliers) as well as bondholders. In Chapter 11, the company wants to "reorganize." This means that the company wants a bankruptcy judge to figure out how some of the assets can be sold to give some money to creditors, but some assets can be kept so that the corporation can start over "with a clean slate."

Individuals can also declare personal bankruptcy. Suppose you have lost your job. You can no longer pay your mortgage payment, or your car payments, or your credit card bills, or any other debts you have. If you just stop paying these creditors, they will reclaim their collateral (the mortgage company will foreclose on your house and sell it, the car company will repossess the car and sell it, etc.). The credit card companies can't repossess anything because they extended unsecured credit to you. So they can just bring a lawsuit for what they are owed. But what if the mortgage company can't sell your house for enough to cover the amount of your mortgage (for example, what if you owe $100,000 on the house and they only sell it for $80,000)? The mortgage company will sue you for the remaining $20,000 you still owe. The same is true for the cars. The car company will sue you for what you still owe. How do you avoid all these lawsuits? You declare personal bankruptcy.

There are two common types of personal bankruptcy: Chapter 7 and Chapter 13. In Chapter 13, you want to pay back your creditors, but you just need the payments structured and you need all the creditors to stop harassing you. You want to pay them back but you can't pay them back as fast as they are demanding. The bankruptcy judge works out a payment plan between you and your creditors. If you stick to the payment plan, then the creditors are not allowed to harass you (with collection calls, etc.). The fact that you declared Chapter 13 bankruptcy will stay on your credit record for 7 years.

In Chapter 7 bankruptcy, you are declaring that you want to walk away from all your debts and "start over." The bankruptcy judge will return the house to the mortgage company and the cars to the company that financed them. The judge will then order that all your other assets be sold to pay as much of the credit cards as possible until you have nothing left. But then all the creditors are ordered not to seek further reimbursement. No harassing phone calls, no lawsuits. Besides the fact that everything you owned has been taken away and sold to pay your creditors, you now can not declare bankruptcy again for 10 years. And the bankruptcy will stay on your credit record for 10 years. Though you have horrible credit now (you just destroyed it with the bankruptcy), either no one will loan you money or if they do it's at absolutely horrible interest rates. No one will probably rent you a place to live for years because you have a bad habit of not paying your bills. So, bankruptcy gets rid of your debts but at a huge cost. Bankruptcy ruins lives. I know a man that committed suicide rather than declare bankruptcy (he wrote in his will for his sons to pay off his debts from his estate but they kept the money for themselves).

Moral of the story: Bankruptcy is a measure of absolute last resort.

18. Make a Budget.

The only way to really understand your financial situation and to control your financial situation is to create a budget and follow it. A budget is simple to do with Excel. You create a spread sheet with all the categories of places you spend money (Expenses such as Food, Utilities, Gasoline, Rent, Insurance, Pets, Entertainment, Charitable Giving, Savings, etc.). Then you add one more column called Income. Then you figure out what your monthly take home pay is and put that under the Income column. Then you allocate your income to all the Expense columns including Charitable Giving and Savings. The sum of all the Expense columns should equal the Income column (i.e., you account for all the money). Then as you go along during the month, you decrement the amount you spend on expenses from each column. You also decrement the money you earn from the income column. At the end of the month, if everything is perfect, the income column is zero (indicating that you earned exactly what you thought you would). And the expense columns should each be zero (indicating that you spent exactly as your budgeted). Of course, that will never happen because nothing works out exactly as planned. But if you add up what is left over in all the expense columns and the number is > 0, then you spent less than you made (you lived within your means!). If the number is < 0, then you spent more than you made (you lived above your means), and you'll need to make some sort of adjustment the next month.

I did a budget similar to this when your mother and I were first married. But in the last 15 years, I took a simpler approach. I still have a spread sheet with all the same columns and I still record everything we spend and all the money we bring home (down to the penny). Now, at the end of the month I tally all the expense columns and the income column, subtract the total expenses from income and see what I've got. If the number is positive, I put that amount in savings. If the amount is negative, then I know we spent too much and I go back and determine where we went overboard. Sometimes it's eating out. Sometimes it was because we had to pay college tuition. Sometimes it's a big insurance bill. But I make sure I understand where the excess occurred and make sure that we're not getting into a bad habit.

19. Insurance.

a) Homeowner's Insurance: If you own a house and have a mortgage, you have to carry homeowner's insurance. Homeowners insurance covers losses due to fire, sudden accidents (burst water pipe), theft, etc. The mortgage company will require you to have a certain amount of insurance to protect their investment (remember, they really own your house, not you). Even if you own your house outright, you want insurance to protect your investment. Remember, only insure your house for what it will cost to rebuild it. In the event of a total loss due to fire, the land will not have to be replaced and your foundation will not have to be replaced. In other words, consider our house in Friendswood. The house was appraised about about $175,000. But $25,000 of that was the lot and probably $10,000 of that was the foundation. So, theoretically, I only needed to insure the house for $140,000 to protect my interests and the mortgage company's interests. Homeowner's Insurance also covers replacement of the house contents (furniture, clothes, appliances, etc.). It also provides liability insurance in the event someone visiting you injures themselves at your house. For instance, if someone falls down the stairs in your house, they can sue your homeowner's insurance to pay for their doctor visit. Homeowner's insurance can also protect you if you are robbed on the street. For instance, if someone pulls a gun on you and takes your jewelry, you may be able to file a claim against your homeowner's insurance. Read the fine print of the policy to make sure what's covered.

b) Windstorm Insurance: If you live in a coastal county you want to carry windstorm insurance (the mortgage company will probably require it for the same reasons as stated under Homeowner's insurance above). Windstorm covers loss due to hurricanes. I think loss from tornadoes is covered under Homeowner's insurance. It's important to read the fine print of the insurance policy just to be safe. It used to be that commercial homeowner's insurance policies covered wind damage, too, but in recent years, many insurance companies refused to cover it (too much risk, too many losses) so the government stepped in with windstorm insurance.

c) Flood Insurance: If you live in a flood plain (a low lying area defined by the government as prone to flood), then your mortgage company will probably require that you buy flood insurance. There are two "flood plains" to my knowledge, a 20 year flood plain (likely to flood every 20 years) and a 100 year flood plain (likely to flood every 100 years). The house in Friendswood was in the 100 year flood plain and flood insurance was not required by the mortgage company. I didn't start buying flood insurance in Friendswood until about 2006. Flood insurance covers loss due to rising water.

d) Renter's Insurance: If you rent an apartment or a house, renter's insurance covers loss of your possessions due to fire, theft, sudden accidents, etc. It does not cover the structure of the building.

e) Auto Insurance: There are several different kinds of auto insurance and you may want to buy only one or buy all five.

i. Liability: Liability insurance covers damage done to the other driver or drivers. If you cause the accident your liability coverage will pay to repair the damage to their vehicles. Your liability coverage will also pay for any medical expenses incurred by the other driver or drivers. Liability coverage is required by law.

Liability is divided into three categories and each category has a minimum amount of coverage required. The minimums for Texas (in insurance speak) are 25/50/25. The first number is the amount of medical coverage per person. The second number is the amount of medical coverage per accident. The third number is the amount of coverage for property loss per accident. In other words:
$25,000 of coverage for bodily injury per person;
$50,000 of coverage for bodily injury for all people involved;
$25,000 of coverage for damage to all vehicles.

You should carry more liability than the minimums. Think about this. What if you are very unlucky and you cause a 4 car pile-up and lots of people are severely injured and several cars are totaled? The insurance is only going to pay $50,000 for all bodily injury and $25,000 for all the damage to the cars. What happens if that doesn't cover everything? Then the people are going to sue you (or Mom and me if you are still living in our house, or going to college or driving one of our cars) for the difference. I have insured Mom, Matthew, Michelle and me for double the minimums. Robert and Marie, I'd recommend that you do the same if you can afford it. I don't think the cost is that much higher, so for your own protection, I think you can hardly afford not to.

ii. Collision: Collision insurance covers damage done to your car if you cause the accident. It also covers bodily injury to yourself if you caused the accident. Collision coverage is not feasible on older cars because the car may only be worth $4000 but it costs $500 every six months for the insurance. If the other driver is at fault (usually needs to be attested to by a police officer or by the admission of the other driver), then his / her liability coverage will pay to repair your vehicle and cover any bodily injury you experience. If you are involved in a "no-fault" accident (one in which both drivers are equally at fault), then each driver is responsible to repair their own vehicle. An example of a no-fault accident would be where two cars are backing up and hit each other.

iii. Comprehensive: Comprehensive coverage protects against loss from something other than collision. An example of such a loss is theft or damage from flying rocks, etc.

iv. Uninsured Driver: Uninsured driver coverage protects against loss if you are hit by a driver who does not have liability coverage (in violation of the law). Legally, you can sue the person for damages in court. But in reality, the person is likely not carrying liability coverage because they are indigent, so you won't be able to collect from a court judgment anyway.

v. Underinsured Driver: Remember the discussion above about insuring yourself for more than the "minimums" because if you cause a big wreck, people may sue you if their damage exceeds your coverage? This is the inverse. Someone with insurance caused your wreck but they don't have enough insurance to cover all your damage.

vi. Life Insurance: Life insurance pays a "death benefit" (i.e., the amount of the insurance) to your beneficiary (i.e., the person you name to receive the death benefit) in the event of your death. Life insurance usually does not pay in the event of suicide, death due to an act of war, etc. You have to read the fine print of the policy for other exclusions. Life insurance is a must if you have a spouse and/or children and they depend on your income. Life insurance proceeds are not taxed as income. In other words, if you are the beneficiary on a life insurance policy and the person dies, you get the money free of income tax.

    1. Term Life: Life insurance to cover a specific period of time. You might buy it to cover 10 years, 20 years or something like that. Term is the cheapest kind of life

insurance. You pay the premium monthly and at the end of the insurance period, if you haven't died, then there's nothing to show for all those years of paying premiums. For instance, at age 47, I bought a 20 year term life policy that will pay $500,000. I pay $86 per month in premiums. If I die before age 67, Mom will get the $500,000. If I don't, at the end of the 20 years, Mom gets nothing and the $86 per month is gone. Term comes in two flavors: Level Term and Variable Term. Level term means that the premium is the same for the entire term of the policy. Variable term means that the premium goes up as the insured person ages (as you can imagine, it gets more expensive to insure a person the older they get).

2. Whole Life: Life insurance that covers you until you die. It costs much more than term life but it earns a "cash value" as time goes buy (the insurance company actually takes your premium payment and buys term insurance to insure your life and invests the difference on your behalf). The value of this "difference" is called the cash value of the policy. If you cancel the policy at any time (i.e., quit paying the premium), you get the cash value of the policy paid to you. But if you keep paying the premium until the day you die, the cash value of the policy goes back to the insurance policy and your beneficiary gets paid the death benefit. For example, suppose I bought a $500,000 whole life policy at age 47. The premium every month might be $250. The insurance company would actually spend $86 per month insuring me (buying a term policy similar to the one above) and invest the $164 difference on my behalf. Let's say in 25 years I'm age 72 and still living. My policy my have a cash value of $45,000. I can cancel my policy and get the $45,000 but then I'll have no death benefit when I die. Or I can continue to pay the premium and one day my beneficiary will get the $500,000 death benefit when I die. Whole life is very advantageous for the insurance company because they charge high commissions on the policy and they keep a lot of the money that your policy makes. It is usually not a good deal for the consumer.

3. Universal Life: Universal life is a variation on whole life and is usually not a good deal for the consumer for the same reasons as stated above for whole life.

4. Variable Life: Variable life is a variation on whole life and is usually not a good deal for the consumer for the same reasons as stated above for whole life.

5. Annuity: An annuity is considered life insurance, but it's a different animal altogether. In its purest form, an annuity is an investment in which you make a one time payment to the insurance company (i.e., buy the annuity) and the annuity pays you a monthly benefit as long as you live. For example, lets say you save and invest your entire life and when you retire at age 65, you have amassed $500,000. You could take some of that money, let's say $250,000 and buy an annuity. The annuity then pays you a monthly benefit, let's say $2000 every month as long as you live. If you live over 10 years, you make money. If you die before 10 years, the insurance company makes money. The payouts are all based on life expectancy so the insurance company is pretty convinced that they'll be the one making money. There are lots of variations on the type of annuity described above.

In general, the best deal for the consumer is to buy term insurance. It is the cheapest insurance and has the lowest expenses of all the life insurance products. I know it is the best for the consumer because insurance companies don't like you to buy it (it's more profitable for them if you buy whole life, universal life or variable life). If you ever compare insurance policies, you can easily see that if you buy term life insurance and invest the difference yourself then you usually come out ahead. When buying life insurance, your goal is to provide for your spouse and kids after you're gone. That is, you want to replace enough of your income for your survivors to be able to make it. My goal in buying life insurance was to have enough to pay off all debt (i.e., pay off the house), provide enough for all 4 of you to go to college, and provide enough for Mom to live on after y'all were all gone. Some advice given by others is to buy 8 times your annual salary in term insurance. Keep in mind also that you want to buy the insurance only for as long as you need it. For example, I bought $500,000 of term insurance for 20 years but once I reach age 67, it will expire. But by age 67, I'll be retired with hopefully $1,000,000 in the bank plus a small pension from previous employers plus your Mom will have some Social Security, so I think she won't need any insurance proceeds.

f) Title Insurance: If you buy a house or a piece of property, the title (also known as the deed) is the piece of paper that proves your ownership. When you buy a piece of property, you want to make sure that there are no problems with the title. What kind of problems can exist with a title? What if the previous owner had an outstanding loan of $50,000 on the property and he's selling you the property for $40,000. The bank that holds the loan is going to have a "lien" on the title for the $10,000 they are still owed. Someone's got to pay the bank and you don't want it to be you. So, during the purchase process, one of the things you do (whether you know it or not) is buy a title search. A title search looks through all the county court records to identify all "problems" that may exist with the title. If there are problems that can't be rectified prior to the closing date, then you rescind your offer to buy. But what if the title search doesn't identify any problems but years later, a problem with the title surfaces? This is the exact reaon why you buy a title insurance policy. The title policy will reimburse your for damages up to the purchase price of the property if title problems are identified after closing.

g) Private Mortgage Insurance: Also known as PMI. When you get a mortgage on a house, the mortgage company would like some assurance that you are going to pay the mortgage and not just walk away. It's very customary for homebuyers to put down small down payments, which means the homebuyer does not have a lot of their own money invested in the house. That makes them a greater risk to stop paying (or default) on the mortgage. So, mortgage companies will require that you buy PMI to protect them from you defaulting on the mortgage. PMI is not expensive (it might increase your monthly mortgage payment by 5%). Typically, a mortgage company will require you to carry PMI if your down payment is less than 20% of the purchase price of the house. If you have to buy PMI, make sure to ask the mortgage company how long PMI will be required. Usually, the mortgage company will not require PMI once you pay off 20% of your mortgage. But you need to ask and get it in writing (or look for it in writing in the mortgage contract you sign).

h) Health Insurance: Health insurance protects you from loss on several different levels. Health insurance is usually made available to you through your job. It is very expensive to buy on your own. Most health insurance policies provide some amount of reimbursement on almost all medically necessary care. Things like plastic surgery are considered elective (i.e., not medically necessary and are not covered). If you don't have medical insurance available through your job or if you can't afford the "normal" policy yourself, then you should at least try to by a "catastrophic" policy. A catastrophic won't pay anything for doctor's appointments or simple lab procedures or short duration hospitalizations. But they provide a significant amount of coverage in the event of a catastrophic illness or a long, protracted hospitalization. You don't want to be wiped out financially if you had the misfortune of experiencing a catastrophic condition.

i) Dental Insurance: Similar to health insurance except just covers dental and possibly orthodontic services. It too is usually made available to you through your job.

j) Vision Insurance: Similar to health insurance except just covers eyeglasses and contact lenses. It too is usually made available to you through your job.

k) Disability Insurance: Disability insurance replaces part or all of your salary if you become temporarily or permanently disabled and can no longer work. At my job, disability insurance comes in two flavors, short term and long term. Short term disability insurance provides a payment each week which is equivalent to 100% of pay for most people for the first six months that you are absent from work. Long term disability insurance provides a payment each week which is equivalent to 60% of pay after short term disability stops paying (i.e., after 6 months). The reduction to 60% is designed to give you a reason to return to work rather than fake disability to keep from having to work. Disability insurance is a must if you have a spouse and/or children and they depend on your income.

20. Taxes.

There are several kinds of taxes levied by the various levels of government (federal, state, county, city). I'll discuss each of them briefly.

a) Federal Income Tax: Also just called income tax. Everyone who earns money has to file an income tax return (due on April 15 for the previous tax year). Tax is due on earned income (money you are paid by a job) and unearned income (income from investments). Income paid by a company and income paid on investments are reported to the IRS. If you don't file a tax return, the IRS will know it because they'll have income reported to them from other sources. The IRS will then ask to meet with you (an audit) to ask what you are doing.

As I discussed previously, income tax is paid based on tax brackets. These are fictional numbers but the brackets work like this (the brackets change every year, either due to inflation or due to acts of Congress):

Income:	$0	-	$10,000:	0% bracket.
Income:	$10,001	-	$19,000:	11% bracket
Income:	$19,001	-	$50,000:	17% bracket
Income:	$50,001	-	$95,000:	25% bracket
Income:	$95,001	-	$170,000:	31% bracket

If you want to know the real brackets and ranges, look on Google. The way the brackets work as follows. These are simple examples to make the point. In actuality, the tax code is more complicated than this.

Suppose you earn $9,000. You are in the 0% tax bracket so you will not owe tax but you still have to file a tax return to prove it to the IRS.

Suppose you earn $12,000. Your tax bill will be calculated as follows. The first $10,000 is not taxed. The next $2,000 is taxed at 11%. So you'll owe

$0 + ($2,000 * 11%) = $220

Suppose you earn $70,000. Your tax bill will be calculated as follows. The first $10,000 is not taxed. The next $9,000 is taxed at 11% (= $990). The next $31,000 is taxed at 17% (= $5,270). The next $20,000 (the difference between the $70,000 you earned and the $50,001 bottom of the bracket) is taxed at 25% (= $5,000). So you'll owe

$0 + $990 + $5,270 + $5,000 = $11,260.

So, as your income goes up and you move into a higher tax bracket, not everything you earned gets taxed at the higher amount.

The federal government uses the tax code to affect social behavior. For instance, if the government wants you to save money for retirement, they write laws to give tax breaks for investing. If the government wants you to buy a house, they write laws to give tax breaks for buying a house. The government creates two types of tax breaks: tax deductions and tax credits. A tax deduction is an amount that you are allowed to subtract (deduct) from your income before calculating your tax. As an example, let's say you earn $70,000 like in the example above. If you have $5,000 in tax deductions, then you would only be taxed on $65,000 ($70,000 - $5,000). A tax credit is an amount you subtract from the amount of tax you owe. Let's take our example of income of $70,000 from above. Using our fictitious tax tables, we calculated the tax we owe as $11,260. Suppose we have a tax credit of $500. That amount is not subtracted from our income. Rather it is subtracted from the tax bill. In other words, we subtract $500 from the $11,260 to calculate our tax as $10, 760. The following things are popular tax deductions: charitable contributions, interest paid on a home mortgage, capital losses (such as losses in the stock market or other investments), property taxes paid (we'll talk about property taxes below), and money paid for certain college expenses.

Calculating your income tax (i.e., doing your own taxes) sounds complicated, but it's really just a bunch of math. The forms from the IRS tell you how to calculate your taxes. Or you can use software such as Turbo Tax or Tax Cut. Regardless, I recommend that you do your own taxes rather than pay someone to do them for you. If you pay someone to do your taxes, you still have to gather all the paperwork to give the person, so why not do it yourself?

There are some people who allege that the federal income tax is unconstitutional. That argument is based on the following: The US Constitution says that one of Congress' jobs is to "assess tax." The word "assess" means that Congress is supposed to calculate your tax and send you a bill. But for the federal income tax, Congress asks you to calculate what you owe, show the calculations on the tax return, sign the tax return, and send the return and the money to the government. This is not "assessing tax." This is just "collecting the tax." When you sign your tax return, you are swearing to its accuracy. Some people allege that this act is unconstitutional. The argument is by requiring you to sign your tax return, the government is making you testify against yourself and that is a violation of the 5th amendment. The government gets around this because, believe it or not, the tax code says that the federal income tax is voluntary. So there is a small number of people who don't pay their taxes (it's voluntary after all), using these arguments. Sometimes they win in court. Sometimes they go to jail. The problem with going to court to make these arguments is that you're fate is going to eventually be decided by a jury of your peers, a jury of people who've been paying their income tax year after year. They are likely not to be sympathetic.

b) State Income Tax: Texas is one of only two states in the union that doesn't have a state income tax. I don't remember what the other state is. State income tax is similar to federal income tax, just done at the state level. Texas uses other means of taxation to raise money.

c) Property Tax: Tax paid annually on property, such as land, houses and commercial real estate. There are usually two taxing authorities that tax property: The county in which the property resides and the school district where the property resides. This is how counties and school districts get their money to operate. The tax is calculated as a percentage of the appraised value of the property. The percentage is different for each county / ISD (set by the county authorities). The amount you pay in property tax is deductible on your federal income tax. After all, it's not fair to be taxed twice on the same amount of money is it? Paying a tax on a tax payment?

d) Sales Tax: Tax paid on items purchased. In Texas, sales tax is paid on everything except food and medicines. In Texas, two entities collect sales tax. The state of Texas collects the first 6.25%. The city where the purchase is made can assess any amount they want up to 2.0%. For example, in Houston, the sales tax amount is 8.25% (the state gets 6.25%, the city gets 2.0%). In Friendswood, the sales tax amount is 7.75% (the state gets 6.25%, the city gets 1.5%). In San Antonio, the sales tax amount is 8.125% (the state gets 6.25%, the city gets 1.875%). There are a few exceptions regarding sales tax. There is no sales tax on the purchase of a house. Only the "state" portion of the sales tax is collected on the purchase of a car (that is, sales tax on a car is only 6.25%). As of the last couple of years, some or all of your sales tax paid is deductible on your federal income tax.

e) Ad Valorem Tax: Think of this as property tax on you car. It's an annual tax paid based on the value of your car. Many states levy this tax, but Texas is not one them. Texas assesses a vehicle registration fee, but that is just a fixed amount for all cars in a given county, not a tax based on the value of the car.

21. Dave Ramsey.

If you don't know who Dave Ramsey is, he's on talk radio and counsels people about one thing: Get out of debt and stay out. When I discovered him on the radio, I was already doing almost everything that he recommends (because it was just common sense to me). But I bought one of his books, The Total Money Makeover, just to make sure I didn't miss anything. I'd recommend that you read "The Millionaire Next Door" that your mother and I bought each of you. I'd also recommend that you also read "The Total Money Makeover." Millionaire will take a while to read, but the Makeover book is a very quick read.

Dave Ramsey has a simple 6 step approach to saving money, getting out of debt, and then getting rich. Here it is in a nutshell.

Step 1: Save $1000 as a "starter" emergency fund. This will prevent you from using a credit card when some kind of emergency comes up. This could take a couple of months depending on your income.

Step 2: Pay off all your debt except your house (assuming you have debt). Start with the smallest debt first. Get aggressive and pay that one off. Then pay off the next largest debt. Repeat until all debt is paid off. This could take a couple of years depending on how much debt you have.

Step 3: Go back to the emergency fund in Step 1 and add to it a month at a time until you have enough money in it to cover 3-6 months of expenses (in case you lose your job or have a big catastrophe hit). This might take a year.

Step 4: Start saving for retirement every month. He recommends saving 15% of your income. Now that you're out of debt, and you've built up your emergency fund, you should have money to do this and make it a monthly ritual

Step 5: Start saving for your children's college education (assuming you have children). Once you've got Step 4 underway, you should find money in your budget to do this.

Step 6: Pay off the house. The last step. Once the house is paid off, you have no more debt and you should be able to save aggressively. This is when you start buying some of the things you always wanted in life (with cash of course

I can say that Mom and I have done all 6 steps. The book goes into more detail on each step and gives real life examples of problems people have overcome with each step. It is a very quick read.

22. Conclusion.

As I said in the introduction, I am not telling you how to live. I'm just giving you some advice to think about so that, hopefully, you avoid some of the mistakes that I made. Before I was 20 years old, I had two people say things to me that changed my life. I've probably told you these stories before but I'll repeat them here.

The first person was my father. One day after church when I was nearing the end of the 10th grade, my dad and I were sitting in the car waiting on my mom. She, always the talker, was saying goodbye to half a dozen people, but Dad and I were already in the car. My dad asked me what classes I was planning on taking in the 11th grade. I informed him that I'd been thinking and that I'd decided I wasn't going to go to college. Therefore, I wasn't going to stress with taking any more math classes or science classes. I was just going to cruise the last two years and then get a job after graduation. He was shocked. Neither he nor my mom had ever attended college, but they just assumed that my sister and I would go to college. She was already in college, so they were just waiting on me. From my perspective, I saw my dad as being pretty successful, having started his own business in 1969. He wasn't making a lot of money, but certainly enough to be comfortable. And my mom had been working for Sears since the age of 17 and was obviously doing comfortably well also. My dad took a couple of minutes and explained to me that I was looking at their lives 25 years after high school. He informed me that I was not aware of the hard times they had gone through in those 25 years. I was just seeing the end result. He explained that going to college would allow me to avoid some of the hard times they'd been through and that I'd never regret going. I don't remember what I said, but I decided right then and there that I'd go to college. The next day I went to school and signed up for Trig and Biology and made plans to pursue the most difficult classes I could in the 11th grade to get prepared. That five minute conversation changed my life.

The second person was a man named Hugh Smith. One of my mom's best friends was a woman named Billie Smith, Hugh's wife. My mother and father were ignorant about college. They couldn't give any advice about what to major in, about what careers were in demand. All they knew is, 'You've got to go to college." My freshman year, I was in the business school, primarily because my sister has graduated from the business school, so that's all my parents or I knew to do. But I did not like the business classes I'd taken so I didn't think that was the career path for me. Hugh and Billie came to dinner one night (by this time my mom and dad were divorced, and my mom had remarried). At dinner, Mr. Smith asked me how college was going and what I was studying. I told him. He asked, "Have you ever thought about working with computers? I work for AT&T and AT&T developed an operating system called Unix. Computer programmers are making good money and are in high demand. It looks like it's going to be a hot field." Well, just the sound of it was interesting. I knew nothing about computer programming but I knew that I would love it. So that very night I got the university catalog out and began researching what classes I'd already taken that would transfer and began mapping out what I would take each future quarter (we were on a quarter system rather than a semester system). That five minute conversation changed my life.

I don't know if anything in the previous pages will change your life, but I wanted to say it nonetheless. Do with it what you will.