# The Road to Financial Independence:
## A Guide for 20-Somethings

Growing up, you may have eagerly looked forward to being on your own. No one telling you not to eat pizza for breakfast, being able to stay up all hours of the night, putting whatever you want on your walls – what is not to love about it? However, now that you are actually on your own, you may be a little, well, terrified. Along with adult freedoms come adult responsibilities, such as getting a car, renting, establishing your credit, and managing your money so that you can pay all of your bills and still have something left over for savings and fun. Unfortunately, personal finances is a topic that is seldom taught in school. But don't worry, this guide provides you with what you need to know to succeed on the road to financial independence.

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## Money Management

The most common cause of financial problems, such as having credit card debt or not being able to pay bills or save, is spending more than what you are earning. How can you avoid being in this state? One of the best tools for managing your money successfully is to budget. You may be groaning right now, thinking budgeting is about as much fun as taking a trip to the dentist, but it is actually a fairly painless process. A budget is simply a plan for how you will spend your money. It does restrict your spending, but it can also help you ensure that there is enough money to do the things that you want to do.

The first step in creating a budget is to write down what your income and expenses are now. You can use the Budgeting Worksheet or create a spreadsheet on your computer. To get a per-month amount for periodic or variable expenses (yes, things like gifts and concerts count, even if you only spend money on them once in a while), total up what you spend per year and divide by 12. What if you are not sure how much you spend on some expenses? Just use your best guess for right now. Then, track your expenses for a month or two (you can use the Tracking Worksheet, a piece of paper, a computer spreadsheet, or budgeting software), so that you can correct any inaccuracies.

- Complete the Budget Worksheet on pages 8-10, and the Tracking Worksheets on page 11-12.

After you list everything, total up all of your expenses and subtract them from your income. If you are spending more than you are earning, you will need to make changes. If your income is $1,800 a month, but your expenses are $2,300 a month, long-term, there is no way you will be able to pay all of your bills and save without relying on credit – or the bank of Mom and Dad (which will probably not stay open forever). Is there any way that you can increase your income (e.g., get a part-time job or work overtime)? Are there any expenses that can be reduced, postponed, or eliminated? Be honest about what is a necessity and what isn't. (Eating out for lunch every day or having cable television is nice, but you don't need them to live.) List any changes you plan on making in your budget.

Even if you are not currently spending more than you are earning, it is a good idea to review your budget and think about if you want to make any changes. Do you want to take art classes? Go on a nice vacation? Save more? (Saving is something that everyone should do. In addition to saving for specific goals, such as a down payment on a house, it is wise to establish a general emergency fund. If you have an unexpected expense or lose your job, that emergency fund will allow you to pay your bills without relying on credit.) If adding money for these expenses puts you in the red, see what else you can cut – remember, your expenses should never exceed your income.

Once you create a budget, the hard work is over, right? Not exactly. In order for your budget to be useful, and not just a scrap piece of paper, you need to follow it. Tracking your expenses on an ongoing basis is a good way to know when you have reached your spending limit for the month in a particular category. Recording your purchases at the end of the day should only take a few minutes. (If you use budgeting software that links to your checking and credit card accounts and automatically imports and categories your purchases, the process is even easier.) If you are finding it hard to stick your budget on a regular basis, some of your figures may have been unrealistic. Go back over your budget and make adjustments. Perhaps you realized you cannot live on rice and beans and spend only $25 a month at the supermarket, but you can spend less money on clothing.

# Checking Account Management

Having a checking account makes life much easier – and it is much safer than keeping your money under your mattress – but many people get into trouble by failing to follow the golden rule of checking account management: ensuring that there is enough money in your account to cover your transactions. What exactly happens if you do try to use your debit card or write a check when you do not have enough money in your account? That depends on the way your account is set up:

- If you elect not to allow overdrawing as a feature of your account, your balance cannot go below zero. Your debit card transactions will be denied, and your checks will bounce. For each check that you bounce, you can be charged a NSF (non-sufficient funds) fee. If you frequently write bad checks, you could lose your account, and you could even be subject to legal actions.

- If you elect to allow overdrawing, your balance can go below zero, so debit card and check transactions will not be denied even if you do not have the funds in your account. (However, your account may have a limit as to the amount you can be overdrawn.).

    - If you do not have overdraft protection, you will likely be charged a fee every time you overdraw your account. Furthermore, the money that you owe to your financial institution (the amount you are overdrawn) can be deducted from your account immediately the next time you make a deposit. Like when you bounce checks, your account could be closed if you routinely overdraw your account.

    - If you have overdraft protection, your checking account is linked to your savings account, credit card, or a line of credit, and the amount that you overdraw is automatically deducted from or charged to that. There is often a monthly fee for this service, but it is usually less than overdraft and bounced check fees.

Having overdraft protection can shield you from being charged high fees and having your account closed, but the best option is to not overdraw or bounce checks in the first place. Remember, when you overdraw your account, you are not given free money – you must pay back the amount you overdraw.

Monitoring your account balance is a good way to prevent overdrawing or bouncing checks. Is it necessary to check your balance every time you want to buy a $1 pack of gum or $3 magazine? No, but it is a good idea to do so whenever you are not sure if there is enough money in your account. In this day and age, knowing your balance is a snap – most financial institutions will let you check it over the phone or on-line. (Remember to subtract from your balance the amount of any automatic debits that will occur before your next deposit and outstanding checks.) It can also be helpful to have a cushion of a few hundred dollars in your checking account – if you typically only have $3 left in your account before the next payday, you are more likely to overdraw than if you have $300.

# Credit

Having a positive credit report and score can provide many benefits. Not only are you more likely to be approved for credit in the future and receive a lower rate (which will come in handy in if you want to buy a house some day), but it may also be easier for you to rent an apartment, get good rates on your insurance, and perhaps even get a job (yes, some employers check your credit).

In order to have a good credit report and score, you need to have and use credit responsibly. Many people start with a credit card. (Even if you have student loans, having a credit card will still help you build good credit.) When deciding what credit card to apply for, note and compare the important features of each card, including the:

- **Annual percentage rate (APR):** This is the interest that you are charged on any balance that you carry over, or do not pay off, each month. If you pay off your balance in full every month, the APR is not important, but it doesn't hurt to look for a card with a low APR just in case. If the card comes with a teaser rate – a low or no interest rate for a temporary period of time – don't forget to check what the interest rate will be once the teaser rate expires.

- **Credit limit:** The credit limit is the maximum amount you can borrow at any given point in time. Having a higher credit limit is better for your credit score, but if you are worried you will overspend, it may be a good idea to look for a card with a lower limit.

- **Fees:** It is standard for creditors to charge a fee for paying late or going over the credit limit. Some cards also charge an annual fee. You should avoid cards that charge an annual fee unless you are new to credit and that is all you can get (discussed more later).

- **Rewards:** Rewards are perks, such as cash back or gift certificates, that come with using the card. Having perks is nice, but be careful – sometimes rewards cards charge higher interest and fees than credit cards that don't come with rewards.

While getting a credit card is much easier than getting a mortgage or car loan, if you do not have a credit history, you may find it difficult to get approved for that first card. All hope is not lost, however. One possible option is a store card. You can only use it at the store associated with the card, but it is usually easier to get approval compared to a regular credit card. Another option is secured credit card, which requires you to put down a deposit. If you fail to make payments, the money you owe is deducted from the deposit. The credit limit on secured credit cards is usually low, and you will probably have to pay an annual fee, but many creditors are willing to convert a secured card to a regular card after a year or two of on-time payments. Lastly, you can have someone with a good credit history co-sign your credit application. You have to be extremely careful with this option, as the account history will appear on the co-signer's credit report and the creditor can collect from him or her if you do not make the payments. If you mismanage the account, you could sour your relationship with the co-signer.

Once you have a credit card, use it wisely:

- **Stay out of debt.** It doesn't take long for a few purchases to add up to hundreds, even thousands, of dollars. Don't charge more than you can afford to repay by the time the bill comes in.

- **Pay it off.** If you do get into debt, commit yourself to getting debt free as soon as possible. Pay more than the minimum, and don't charge more on the cards until your balance is at zero. Seek help from a reputable credit counseling agency if you are having difficulties managing the debt on your own.

- **Pay on time.** If you miss a payment, your credit score can take a quick and hard hit. Furthermore, you may be charged a late payment fee.

- **Limit the number of cards you have.** (2-4 is usually a good number.) The more open credit lines you have, the more you may be tempted to spend beyond your means. Also, applying for credit too often can hurt your credit score.

## Renting



The first step in flying the coop and getting your own nest is to think about what you want in an apartment. How much can you afford to spend? (Don't forget you will likely be paying utilities on top of rent.) How many bedrooms do you want? What is your ideal location? What amenities do you want? Do you want a roommate? (Having a roommate will usually save you money, but it also means you could be living with someone who drives you crazy or does not pay his or her share of the rent, so if you decide you want a roommate, you should choose carefully.) Do you want a place that is pet-friendly? Also, since you may not be able to get a fabulous 3 bedroom-pad in the heart of downtown with parking, a swimming pool, and a gym for $300 a month, which are the things that are deal breakers, and which are the things you can live without?

Once you know what you want, you are ready to start the hunt. You can usually find listings on-line or by driving through the neighborhood you are interested in and looking for "For Rent" signs. There are also brokers that show apartments (many real estate agencies have a rental division), although keep in mind that they may charge a fee. When you find something that you like, usually the landlord will want you to submit an application listing your personal information, past rental history, and income/employment status, and he or she may also check your credit report. What if you have not yet established a credit history? Some landlords are willing to overlook this. (Individual landlords are often more flexible than property management companies.) Another option is to have someone co-sign on the lease.

After your application is approved and you decide you want the place, typically the next steps are to pay the security deposit and first month's rent and sign the lease. As the name implies, the security deposit provides security to the landlord – if you leave the apartment without having paid all of your rent or caused damage, the landlord can cover the rent or repairs with the funds from your deposit. Otherwise, it will be returned to you when you leave. State law determines the maximum amount a landlord can charge for the security deposit. It is a good idea to know what it is in your state to be sure that the landlord is not trying to take advantage of you.

The lease is a legal document that governs the terms of your tenancy. It typically spells out the monthly rent, due date, length of the lease, and rules that you must follow (e.g., whether you can sublet the place, whether you can have pets, whether you can paint the walls). Before you sign the lease, it is important to read it over carefully. If you disagree with anything (perhaps you want to have hot pink walls and the lease says that no painting is allowed) ask the landlord if he or she is willing to change it. Once you and the landlord sign the lease, it is binding for the length of the lease. This works both ways, meaning not only do you have to follow the terms, but your landlord does too. If the lease says that the rent is $700 a month, your landlord cannot change it to $800 a month. However, once the existing lease ends, your landlord can create a new lease with different terms.

Most leases are for an extended, fixed time period (usually a year). If there is no specified time period, the lease is month-to-month. (It may be called a rental agreement instead of a lease.) It automatically renews each month unless one party terminates it. Generally, only 30-days notice is needed to terminate or change the terms of the lease, unless state law says otherwise.

Once you move in, it is very important to pay the rent on time and follow the rules. Failure to do either can result in you being sent an eviction notice. If you do ever find yourself in a position where you cannot pay the rent, call your landlord right away and see if you can work out a payment plan. If you are breaking your lease early, remember that you are still responsible for the rent for the months remaining under the lease. This does not necessarily mean that you will wind up having to pay all that rent yourself, though. The landlord must try to re-rent the unit, and once there is a new tenant, you no longer have to pay (unless the rent the new tenant is paying is less than what you paid, in which case, you are responsible for the difference). Instead of having to wait until the unit is re-rented, some landlords will let you off the hook if you pay an early termination fee. This may not be a good option in a strong rental market, but you may want to take advantage of it if you expect your apartment to sit empty for a while.



## Buying a Car

A vehicle is the first major purchase many young adults make. However, before you buy, make sure you know how much you can really afford. It is easy to get carried away and end up with a car or truck that is out of your price range. Revisit your budget, and see how much cash you can spare each month for a car. Consider not just the monthly loan payments, but also the cost of insurance, maintenance and repairs, gas, and parking.

One of the biggest decisions that car buyers face is whether to go with a new or used car. If money was no object, most people would prefer to buy a new car. Not only do you get that nice new car smell, but you get a car that probably won’t need major maintenance for several years, is reliable, and has the most up-to-date safety features. Of course, in the real world, money is an object, and the used version is almost always cheaper. A cheaper car means lower loan payments or perhaps even being able to buy the car outright with savings.

If you decide to buy a used car, there are many places you can get one from, including a new car dealership, private seller, used car lot, rental car company, or auction. You will generally pay the most at a dealership, especially if you get a certified pre-owned vehicle. (Certified pre-owned vehicles undergo a thorough inspection and are backed by a warranty.) However, many people prefer buying a used car at a dealership because they typically have a large selection and if there is a problem, you don't have to worry about tracking them down like you would if you bought a car from a private seller. Auctions often provide the best deal, but auction cars are often in bad shape and sold "as is", and you may not get a chance to thoroughly inspect them before the auction or obtain the repair history.

To minimize the risk of winding up with a clunker, it is a good idea to do some research before purchasing a used car. Ask the seller for the vehicle's repair history and VIN (vehicle identification number). With the VIN, you can run a vehicle history report. (There are a few companies that will do this for you for a fee.) The report reveals such information as whether the car has been in a major accident, if the odometer has been tampered with, and how many past owners the car has had. Also, if possible, take the car to an independent mechanic to have it inspected.

There are three basic options for car financing: the dealership where your purchase the car, a credit union/ bank, or a finance company. (Dealerships generally do not directly provide the cash but rather arrange financing on your behalf with another company, commonly the manufacturer's financing arm.) Dealerships often offer a promotional low or zero percent interest rate on certain models but may not offer the lowest interest rate on other models. That is why it is a good idea to see what financing your financial institution offers. An added bonus is that you can use a loan from your financial institution to purchase a car at any dealership. Finance companies often specialize in offering subprime loans – loans to people with poor credit. Subprime loans come with a higher interest rate than prime loans. If you can only get a subprime loan through a finance company, it may be preferable to work on improving your credit score first and hold off on getting a new car until you can get a loan with a better interest rate.

A car loan is a legal obligation. Before signing the loan documents, read them and make sure you understand the following aspects of the loan agreement:

- Amount you are financing
- Annual percentage rate
- Finance charges (the total amount borrowing will cost you)
- Payment amount and number of payments
- Whether there are any penalties, such as a late-payment or pre-payment penalty

The lender is required to disclose all of the above information in Truth in Lending Disclosure Statement, which must be given to you before the loan is closed (finalized). Read this statement carefully, and don't be afraid to ask your lender questions.

The road to financial independence is not always a straight one, but with knowledge and enthusiasm, you'll get there.

# Budget Worksheet

**Monthly Income.** Enter your gross and net (after taxes) income from all sources. For income received infrequently, such as bonuses or tax returns, calculate the annual income, then divide by 12 to find the monthly amount.

| Source | Gross | Net |
|---|---|---|
| Job | | |
| Spouse's job | | |
| Part-time job | | |
| Rental/room & board received | | |
| Commissions/bonuses | | |
| Tax refunds | | |
| Investment income | | |
| Government benefits | | |
| Unemployment insurance | | |
| Child support/alimony | | |
| Support from family/friends | | |
| Other | | |
| **Total** | | |

**Monthly Expenses.** Since many expenses are variable, such as utilities and groceries, it is important to average these expenses. Other expenses are periodic (such as insurance or vehicle registration). Again, calculate the annual amount and divide by 12.

| Category | Expense | Monthly Average | Monthly Goal |
|---|---|---|---|
| HOUSING | Rent/Mortgage | | |
| | 2nd Mortgage/Equity Line | | |
| | Homeowner's/Renter's Insurance | | |
| | Condo Fees/HOA Dues | | |
| | Home Maintenance | | |
| | Gas/Electric | | |
| | Water/Sewer/Garbage | | |
| | Telephone | | |
| FOOD | Groceries/Household Items | | |
| | At Work/School | | |
| INSURANCE (Exclude payroll deducted amounts) | Health/Dental/Vision | | |
| | Life/Disability | | |
| MEDICAL CARE (Exclude payroll deducted amounts) | Doctor/Chiropractor | | |
| | Optometrist/Lenses | | |
| | Dentist/Orthodontist | | |
| | Prescriptions | | |
| TRANSPORTATION (Exclude payroll deducted amounts) | Car Payment #1 | | |
| | Car Payment #2 | | |
| | Auto Insurance | | |
| | Registration | | |
| | Gasoline/Oil | | |
| | Maintenance/Repairs | | |
| | Public Transportation/Tolls/Parking | | |
| CHILD CARE (Exclude payroll deducted amounts) | Daycare | | |
| | Child Support/Alimony | | |
| SAVINGS | Emergency | | |
| | Goals | | |
| INCOME TAXES | Prior Year | | |
| | Estimated Tax Payments (Self-Employed) | | |

| Category | Expense | Monthly Average | Monthly Goal |
|---|---|---|---|
| UNSECURED DEBT | Loan payment | | |
| | Credit Card #1 | | |
| | Credit Card #2 | | |
| PERSONAL | Beauty/Barber | | |
| | Clothing/Jewelry | | |
| | Cosmetics/Manicure | | |
| ENTERTAINMENT | Cable/Satellite | | |
| | Movies/Concerts/Theater | | |
| | Books/Magazines | | |
| | CD/Tapes/Videos/DVD | | |
| | Dining Out | | |
| | Sports/Hobbies | | |
| | Vacation/Travel | | |
| MISCELLANEOUS | Banking Fees | | |
| | Laundry | | |
| | Union Dues | | |
| | Internet Service | | |
| | Pet Care | | |
| | Gifts for Holidays/Birthdays | | |
| | Cell Phone/Pager | | |
| | Postage | | |
| | Cigarettes/Alcohol | | |
| | Contributions to Church/Charity | | |
| | Other | | |
| | Other | | |
| | Other | | |
| **Totals** (include totals from previous page) | | | |



**Bottom Line.** Once you have determined the total of your take-home pay and expenses you are ready to determine your bottom line. Subtract the total of all expenses including debt payments from your net income. If the result is a positive number, you can add the extra money to your savings to reach your goals sooner. If your expenses exceed your income, you'll need to make some adjustments to bring your finances back into balance.

| Total Monthly Income | Total Expenses | Balance |
|---|---|---|
| | – | = |

# Weekly Expense Tracking Worksheet

If you don't know where your money is going, it's time to start tracking your spending. Different methods of tracking work for different people – some like to save receipts while others prefer to jot down all purchases in a small notebook they carry with them. Remember, tracking is only effective if you count every expense, including the morning newspaper and the change you put in the office vending machine. Use the sheets on the next two pages to record weekly and monthly spending totals.

| Item | Mon | Tue | Wed | Thu | Fri | Sat | Sun | Total Expenses | Weekly Budget | Over / Under |
|---|---|---|---|---|---|---|---|---|---|---|
| Groceries | | | | | | | | | | |
| Restaurants | | | | | | | | | | |
| Laundry/Dry Cleaning | | | | | | | | | | |
| Medical/Dental | | | | | | | | | | |
| Auto/Gas/Parking | | | | | | | | | | |
| Other Transportation | | | | | | | | | | |
| Child Care | | | | | | | | | | |
| Personal Care | | | | | | | | | | |
| Clothing | | | | | | | | | | |
| Bank Fees/Postage | | | | | | | | | | |
| Entertainment | | | | | | | | | | |
| Books/Music/Video | | | | | | | | | | |
| Cigarettes/Alcohol | | | | | | | | | | |
| Gifts/Cards | | | | | | | | | | |
| Home/Garden | | | | | | | | | | |
| Church/Charity | | | | | | | | | | |
| Savings | | | | | | | | | | |
| Other | | | | | | | | | | |
| Other | | | | | | | | | | |
| Other | | | | | | | | | | |
| **Weekly Totals** | | | | | | | | | | |

# Monthly Expense Tracking Worksheet

| Item | Week 1 | Week 2 | Week 3 | Week 4 | Week 5 | Total Expenses | Monthly Budget | Over / Under |
|---|---|---|---|---|---|---|---|---|
| Groceries | | | | | | | | |
| Restaurants | | | | | | | | |
| Laundry/Dry Cleaning | | | | | | | | |
| Medical/Dental | | | | | | | | |
| Auto/Gas/Parking | | | | | | | | |
| Other Transportation | | | | | | | | |
| Child Care | | | | | | | | |
| Personal Care | | | | | | | | |
| Clothing | | | | | | | | |
| Bank Fees/Postage | | | | | | | | |
| Entertainment | | | | | | | | |
| Books/Music/Video | | | | | | | | |
| Cigarettes/Alcohol | | | | | | | | |
| Gifts/Cards | | | | | | | | |
| Home/Garden | | | | | | | | |
| Church/Charity | | | | | | | | |
| Savings | | | | | | | | |
| Other | | | | | | | | |
| Other | | | | | | | | |
| Other | | | | | | | | |
| **Monthly Totals** | | | | | | | | |