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Newsletter

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This newsletter is focused on issues related to education. The first article discusses some typical financial myths, mistakes and misunderstandings that people have at various stages of their lives. The second article has personal finance tips for new graduates. Feel free to forward the newsletter (or that article) to any new graduates you know. The third article discusses a dilemma of many parents--do you fund college for your children, your own retirement, or both? Finally, the last two articles address issues concerning student loan debt.

With the large number of identity theft tax cases reported nationwide by the IRS this past filing season, I plan to address the issue of identity theft and information security in the next newsletter.

I hope you find this information, along with the articles contained in the newsletter to be helpful. As always, if you have any questions, please contact me.

Happy Spring!

Eric

April 2015

Financial Myths, Mistakes, and Misunderstandings

Throughout our financial lives, we may be influenced by myths, mistakes, and misunderstandings (MMMs). Here are just a few.

In the beginning . . .

"I don't invest because I don't know much about it." It's time to learn, because a basic understanding of investing concepts can help you make more informed financial decisions.

"Wow, they'll give me that much credit! I must be able to handle it." Just because the credit-card company or bank extends a large amount of credit to you, it doesn't mean you should use all of it. The more you borrow, the larger the monthly payments, and before you know it, you've bitten off more than you can chew. Figure out how much you'll owe based on the amount you borrow and determine if it will fit within your budget. Generally speaking, if you can't afford the payment, don't incur the debt.

"I'm young. I'll worry about retirement when I'm older." Planning for retirement involves saving enough by a desired age to enable you to support yourself without having to work. If you wait to begin saving for retirement, you'll have to sock more away or put off retirement to a later date. So the earlier you begin saving, the better.

Go figure

Sometimes we think we know something and rely on it as being correct, when in fact it couldn't be further from the truth.

"I know my finances like the back of my hand. I don't need to write them down." You'd be surprised how often we think we know how much we can afford until our bills start to exceed our income. If you write down your expenses and income (e.g., create a spending plan or budget), you'll know how much you can spend.

"I'll dip into my retirement account and make it up later." First, if you borrow from your 401(k), you'll likely pay fees and interest. If you take money from a traditional IRA, you'll pay income tax on the amount you take and possibly a 10% penalty. Remember, these accounts are intended for retirement. Taking money out now increases the risk you might run out of money during retirement.

"My child will pay back the money I loaned to him or her." Good luck. That "loan" is probably going to turn into a gift, which isn't necessarily a bad thing if it really helps your child, but be sure you can afford the loan/gift before making it.

And later on . . .

As we get older, we may fall prey to some MMMs that can be the source of needless angst, such as:

"I won't need as much income in retirement." Maybe, but it might be a mistake to count on it. In fact, in the early years of retirement, you may find that you spend just as much money, or maybe more, than when you were working, especially if you are still paying a mortgage. And don't forget to factor in increasing health-care costs.

And speaking of health care, **"the new health-care law cuts my basic Medicare benefits and services."** Just the opposite is true. The Affordable Care Act (ACA) mandates that no guaranteed Medicare benefits are cut. In fact, the ACA expands Medicare benefits to include a free annual wellness assessment.

And finally, **"If I die without a will, the state will get my assets and property."** This isn't necessarily true. Each state has intestacy laws, which determine who gets what when someone dies without a will. But those laws generally deal with assets in your name at your death that don't have a designated beneficiary or joint owner. In any case, if you want to have some say in who will inherit your assets after your death, you need to prepare an estate plan, which probably includes a will.

Tips for paying off student loans:

- ***To make your payment schedule easier, consider consolidating or refinancing your student loans***
- ***To shorten the overall repayment term and save on interest charges, try to divert extra funds toward monthly principal prepayment***
- ***If you are having trouble paying your federal student loans, look into the government's Income-Based Repayment (IBR) plan***

Personal Finance Tips for New Graduates

You've marched along to *Pomp and Circumstance* and collected your diploma--now you're ready to finally head out on your own. Maybe you have student loans that you need to start paying back. Perhaps you're looking forward to making your first car purchase or starting a new job. Whatever your situation, you'll definitely have new financial challenges you'll need to address and financial goals that you'll want to accomplish during this stage in your life. Fortunately, there are some relatively simple steps you can take to get started on the right track with your personal finances.

Create a budget

An easy way to maintain control of your finances is to create a budget. Ideally, a budget will assist you in making sure that you are spending less than you earn.

In order to create a budget, you'll need to identify your current monthly income and expenses. Income includes your regular salary and wages, along with other types of income such as dividends and interest.

When it comes to identifying your expenses, it may be helpful to divide them into two categories: fixed and discretionary. Fixed expenses include things that are necessities, such as rent, transportation, and student loan payments. Discretionary expenses include things like entertainment, vacations, and hobbies. You'll want to include out-of-pattern expenses (e.g., holiday gifts, auto repair bills) in your budget as well.

The most important part of budgeting is sticking to it. To help you stay on track:

- Try to make budgeting a part of your daily routine
- Build the occasional reward into your budget (e.g., splurge on a latte at the local coffee shop or have dinner at a restaurant instead of cooking at home)
- Be sure to evaluate and monitor your budget regularly and adjust/make changes as needed

Make saving a priority

Whether it's setting enough aside on a regular basis to accumulate an emergency cash reserve or putting money into an employer-sponsored retirement plan, if your budget allows, you should make saving a priority. And being a young investor means that you have one powerful advantage over older generations--time. By making saving a priority early in your life, your money can have more time to potentially grow and take advantage of the value of compound interest. To make it even easier to save, you can arrange to have a portion of your paycheck/earnings directly deposited into a savings or investment account.

Get a handle on your debt situation

Whether it's debt from student loans or credit cards, it's important to avoid the financial pitfalls that sometimes go hand-in-hand with borrowing. In order to manage your debt situation properly:

- Keep track of loan balances and interest rates
- Develop a plan to manage your payments and avoid late fees
- Pay off high interest debt first or take advantage of debt consolidation/refinancing

Understand the importance of having good credit

Credit reports affect so many different aspects of one's financial situation--from being able to obtain a car loan to being a prerequisite for employment. Having a good credit report will allow you to obtain credit when you need it, and often at a lower interest rate. As a result, it's important to establish and maintain a good credit history by avoiding late payments on existing loans and eliminating unpaid debts. Finally, it's important to monitor your credit report on a regular basis for possible errors.

Evaluate your insurance needs

As a younger individual, insurance is probably not the first thing that comes to mind when you think about your finances. However, having the right amount of insurance to protect yourself against possible losses is an important part of any financial plan. Your insurance needs will depend on your individual circumstances. For example, if you rent an apartment, you'll need to obtain renters insurance to protect against loss or damage to your personal property. If you own a car, you'll need to have appropriate coverage for that as well. You'll also want to evaluate your needs for other types of insurance (e.g., disability and life).

Finally, under the Affordable Care Act, everyone, regardless of age, must have qualifying health insurance or risk paying a possible penalty. If you don't have access to health insurance through your parent's health plan or an employer- or government-sponsored health plan, you may purchase an individual health plan through either the federal or a state-based health insurance Exchange Marketplace. You can visit www.healthcare.gov for more information.

Financial Choices: College, Retirement, or Both?

A juggling act

It's the paramount financial conflict many families face, especially as more couples start having children later in life. Should you save for college or retirement? The pressure is fierce on both sides.

Note

**All investing involves risk, including the possible loss of principal, and there can be no guarantee that any investing strategy will be successful.*

Life is full of choices. Should you watch *Breaking Bad* or *Modern Family?* Eat leftovers for dinner or order out? Exercise before work or after? Some choices, though, are much more significant. Here is one such financial dilemma for parents.

Should you save for retirement or college?

It's the paramount financial conflict many parents face, especially as more couples start having children later in life. Should you save for college or retirement? The pressure is fierce on both sides.

Over the past 20 years, college costs have grown roughly 4% to 6% each year--generally double the rate of inflation and typical salary increases--with the price for four years at an average private college now hitting $192,876, and a whopping $262,917 at the most expensive private colleges. Even public colleges, whose costs a generation ago could be covered mostly by student summer jobs and some parental scrimping, now total about $100,000 for four years (Source: College Board's Trends in College Pricing 2013 and assumed 5% annual college inflation). Many parents have more than one child, adding to the strain. Yet without a college degree, many jobs and career paths are off limits.

On the other side, the pressure to save for retirement is intense. Longer life expectancies, disappearing pensions, and the uncertainty of Social Security's long-term fiscal health make it critical to build the biggest nest egg you can during your working years. In order to maintain your current standard of living in retirement, a general guideline is to accumulate enough savings to replace 60% to 90% of your current income in retirement--a sum that could equal hundreds of thousands of dollars or more. And with retirements that can last 20 to 30 years or longer, it's essential to factor in inflation, which can take a big bite out of your purchasing power and has averaged 2.5% per year over the past 20 years (Source: Consumer Price Index data published by the U.S. Department of Labor, 2013).

So with these two competing financial needs and often limited funds, what's a parent to do?

The prevailing wisdom

Answer: retirement should win out. Saving for retirement should be something you do no matter what. It's an investment in your future security when you'll no longer be bringing home a paycheck, and it generally should take precedence over saving for your child's college education.

It's akin to putting on your own oxygen mask first, and then securing your child's. Unless your retirement plan is to have your children be on the hook for taking care of you financially later in life, retirement funding should come first.

And yet ...

It's unrealistic to expect parents to ignore college funding altogether, and that approach really isn't smart anyway because regular contributions--even small ones--can add up over time. One possible solution is to figure out what you can afford to save each month and then split your savings, with a focus on retirement. So, for example, you might decide to allocate 85% of your savings to retirement and 15% to college, or 80/20 or 75/25, or whatever ratio works for you.

Although saving for retirement should take priority, setting aside even a small amount for college can help. For example, parents of a preschooler who save $100 per month for 15 years would have $24,609, assuming an average 4% return. Saving $200 per month in the same scenario would net $49,218.* These aren't staggering numbers, but you might be able to add to your savings over the years, and if nothing else, think of this sum as a down payment--many parents don't save the full amount before college. Rather, they try to save as much as they can, then look for other ways to help pay the bills at college time. Like what?

Loans, for one. Borrowing excessively isn't prudent, but the federal government allows undergraduate students to borrow up to $27,000 in Stafford Loans over four years--a relatively reasonable amount--and these loans come with an income-based repayment option down the road. In addition, your child can apply for merit scholarships at the colleges he or she is applying to, and may be eligible for need-based college grants. And there are other ways to lower costs--like attending State U over Private U, living at home, graduating in three years instead of four, earning credits through MOOCs (massive open online courses), working during college, or maybe not attending college right away or even at all.

In fact, last summer, a senior vice president at Google responsible for hiring practices at the company noted that 14% of some teams included people who never went to college, but who nevertheless possessed the problem solving, leadership, intellectual humility, and creative skills Google is looking for ("In Head-Hunting, Big Data May Not Be Such a Big Deal," *New York Times,* June 19, 2013). One more reason to put a check in the retirement column.

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Should I co-sign my daughter's private student loan?

Today, many students turn to private lenders to help cover the cost of college. Unfortunately, private student loans don't carry many of the same protections as federal student loans. As a result, you should be aware of the risks associated with acting as a co-signer for these types of loans.

According to the Consumer Financial Protection Bureau, approximately 90% of all private student loans were co-signed in 2011 (Source: Consumer Financial Protection Bureau, Mid Year Update on Student Loan Complaints, April 2014). Private lenders often require a co-signer if a borrower has little or no credit history. In addition, having a co-signer often allows a borrower to obtain a lower interest rate for a loan.

When co-signing any loan, you need to be aware that as co-signor, you are being asked to guarantee the loan. In other words, if your daughter doesn't make her loan payments, the lender can go after you for payment of the loan. Depending on the loan terms, a lender can even demand full payment of a loan from a co-signer if the borrower misses just one payment. In addition, a lender can attempt to collect a loan that is due by using traditional debt collection methods, including wage garnishment.

Before you co-sign your daughter's loan, you'll want to consider whether you will be able to afford to pay her loan if she is unable to make her loan payments. In addition, you should find out how co-signing the loan will impact your current creditworthiness.

Finally, if you do end up co-signing your daughter's loan, you should also find out whether the loan document contains a provision regarding automatic defaults or "auto defaults." An "auto default" situation arises when the co-signor for a loan dies or declares bankruptcy and the lender demands the full amount of the loan to be paid back immediately by the borrower. If the loan does have an "auto default" clause, your daughter should be fully aware of the possible consequences and take steps once she has graduated and is in repayment to pursue a co-signer release for the loan.

How much money should a student borrow for college?

There's no magic formula to determine how much you or your child should borrow to pay for college. That being said, there is such a thing as borrowing too much. How much is too much? Well, college counselors typically recommend that students borrow no more than the amount they expect to earn in their first year out of college, which in turn depends on a student's individual major and job prospects. So, for example, a student planning to get an engineering degree might borrow about $50,000 or $60,000 if he or she expects to obtain a job after college paying that much, while a student majoring in social work might borrow much less.

But this guideline is just that--a guideline. Just as many homeowners got burned taking out larger mortgages than they could really afford (even though their lenders may have told them they were "qualified" for that amount), many students are getting burned borrowing amounts that may have seemed reasonable at first glance but now in reality are not.

Remember, student loans will need to be paid back over a term of 10 years or longer. What if the engineering graduate doesn't have that steady, well-paying job for 10 years? What if he or she decides to step out of the workforce to care for children? What if the company downsizes? What happens when other expenses like housing, utilities, car payments, daycare, and home repairs come down the pike? What if he or she wants to go on to graduate school? Any interruption in the payment of these student loans via deferment or forbearance requests will only add to a borrower's overall balance.

According to the Project on Student Debt, 71% of students who graduated from college in 2012 had student loan debt, and the average balance was $29,400 *(Student Debt and the Class of 2012,* December 2013). With a 10-year term and a 3.8% interest rate (the current rate on federal Stafford Loans), the monthly payment would be $295. But borrow a bit more, say $40,000 total, and the monthly payment jumps to $401. And these figures are conservative, because the interest rates on federal Stafford Loans and private student loans have nowhere to go but up. So student borrowers beware! Don't be led blindly into excessive student loan debt based on a guideline you didn't create.