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Money Mechanics | record keeping

For some families, getting financial records in order mimics Mark Twain's conclusion about the weather: "Everybody talks about it, but nobody does anything about it." Yet, there is nothing too time consuming or difficult about keeping an accurate finger on your financial pulse. Once you've set up a system, the process is fairly mechanical and much more efficient than receipts scattered all over the house. The payoff for good record keeping comes all year long—when insurance coverage needs reviewing, when you apply for a loan and need a statement of your net worth, at tax time, and most of all, when you plan future expenditures.

Record keeping can:

• help you keep a close tab on where the money goes, which can be especially important in inflationary times.

• help you manage daily family financial responsibilities.

• help you locate records and business papers easily when needed.

The best formula for efficient record keeping depends on the individual family. This publication will help you develop a system that works for you.

Some Ground Rules

Make three decisions before setting up a record-keeping system:

1. Choose **one place** to keep your records. This family finance center might be as elaborate as a home office or as simple as a drawer in the kitchen or a file cabinet in the family room. The important thing is that you find a place where all the papers you'll need to manage finances can be stored. It's ideal if there is a work place nearby, too.

2. Decide **who** will take major responsibility for record keeping in your family. Of course, all family members—including children old enough to understand—will want to know how the filing system works and how information can be found easily. Some of the record-keeping tasks can be shared or delegated. But one person with the skills and interest to handle the job will want to take leadership.

3. Develop a **regular schedule** for bookkeeping and resolve to stick to it. A routine will actually reduce the amount of time you spend on record keeping. Set up a regular time during the month to balance the checkbook, fill in the family income and expense records and pay the bills. Spouses may also want to use this time to review past spending and make needed changes in future plans.

Organize With Files

The easiest way to keep track of your financial records is to set up a filing system. You'll want a place to store file folders. A metal filing cabinet, a desk drawer, a cardboard box that fits under the bed, or an accordian folder will do.

Divide your files into two major areas:

1. current financial records
2. permanent records

Every family's filing labels will be different. Divide each area into categories that make sense to you. Some suggestions follow.

In the **current records** section, you might have file folders for:

• bills to be paid. Put incoming bills in this folder. When they are paid, mark them with the date of payment and check number, if applicable, and transfer to the permanent file.

• papers to file. Put all papers, except bills, into this file immediately upon receipt. This will help prevent loss of important papers before you have the time to put them into the permanent file. You'll probably want to empty this "papers to file" folder once a month.

• a notebook for recording current income and expenses. (See section on recording income and expenses for details.)

File headings for the **permanent records** area might include:

• bank accounts. Keep copies of current bank statements, deposit slips and cancelled checks.

• insurance policies. Keep a list of the companies and policy numbers in a safe deposit box.

• annual spending plan. This notebook will contain what you expect to spend on such items as food, clothing, housing, and transportation. Use the same

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notebook to record actual spending. Records of what you planned to save and actually saved can be kept in this notebook, too.

• net worth statement. See section on figuring your net worth for details.)

• tax records. Keep income data and a list of deductions you accumulate during the year.

• housing. If you're renting, keep a copy of the lease. If you buy a house, keep an updated record of the total investment in the property.

• household inventory. Write down the value of personal possessions you buy or receive as gifts during the year. Transfer this information once a year to a complete household inventory kept in a safe deposit box.

• charge accounts. Keep paid bills, a list of account numbers, and the phone number to be called if a credit card is stolen.

• paid bill receipts.

You may also want to designate file folders for employment records, family health records, appliance manuals and warranties, education information, memberships, and retirement, pension, and estate plans.

Dead Storage

You don't have to save everything forever, but some records should be moved to "dead storage" for a time. Clean out current files once a year. Be sure to keep receipts, cancelled checks, and other documents used as evidence for income tax deductions for at least five years. You may wish to keep your copy of income tax returns indefinitely. Items such as insurance policies, appliance service contracts, and warranties should be kept only while they are current.

Safe Deposit Box

You'll want to keep some records in a safe deposit box. As a rule, anything you can't replace or that would be costly or troublesome to replace should go in a safe deposit box. Here are some suggestions:

• birth certificates

• deeds to real estate

• household inventory. In the event your house burns down, this is a valuable record for insurance purposes.

• wills

• marriage and/or marriage dissolution papers

• military service records

It's generally not necessary to keep the following in a safe deposit box: income tax returns, education records, social security cards, warranties, and employment records.

Recording Income and Expenses

One of the records you'll want to keep tells you, at a glance, what you earn and what you spend. An example of a record of income and expenses is shown here. The example shown suggests using one or two pages in a notebook or account book for recording income and expenses in vertical columns. Another approach is to use a separate page for each expense category.

Assign categories appropriate to your situation and decide what to put under them. You may want to enter gross income in the income column and assign an expense category to taxes. Or you may want to enter only net income in the income column and not record taxes.

As another example, you may want two separate categories for food—one for groceries and one for eating out. Combine or divide categories as you see fit, but let simplicity be your rule. The simpler the records, the more likely you are to keep them.

Record of Income and Expenses

Month: ____________________

		Income	Expenses								
Date	Description of Item		Food and beverages	Household operation and maintenance	Furnishings and equipment	Clothing	Personal	Transportation	Medical care	Recreation and education	Gifts and contributions
		$	$	$	$	$	$	$	$	$	$
Total	xxxxxxxxxxxx		$	$	$	$	$	$	$	$	$

Some persons enter all income and expenses daily. Others keep a spindle in a handy place for receipts of cash spending and record these at the end of the week or month. You may want to record only cash expenditures in the notebook and rely on check stubs and credit card receipts for records of other expenditures.

At the end of the month, add up total income and expenses under each heading. Transfer these figures to an annual spending plan in which you have listed expected income and expenses for each month. Comparing what you spent with what you said you would spend will indicate any necessary adjustments in your financial plan or future spending habits.

Figuring Your Net Worth

Another form you'll want as part of your records is a net worth statement. To find out your net worth, just add up the value of all you own—your assets—and subtract the total of all you owe—your debts. This calculation will be needed:

- to apply for a loan
- to determine insurance coverage
- to plot your financial growth
- to make plans for the future

The Net Worth Worksheet on the next page will help you take a reading of your financial pulse. The extra columns are for calculating your net worth in upcoming years. It's a good idea to look at your overall financial situation annually.

Here are some guidelines for calculating assets:

- Ask a real estate agent to estimate the value of your house in today's market. Don't use the price you paid for it.

- Check a used car price guide for the value of your car.

- Make a conservative estimate of the value of household items. Anyone who has had a garage sale knows that even televisions and stereo equipment often don't bring what you think they're worth.

- Use the appraised value for antiques and art.

- Check the newspaper for the market value of stocks and mutual funds.

- Check your policy to find out the cash surrender value of whole or straight life insurance policies.

- The current value of your pension is the amount you could receive if you quit your job today.

Here are some guidelines for calculating debts:

- The balance of your mortgage loan on your house may be on your monthly statement. If not, ask the lender for an amortization schedule of your mortgage.

- List the balance due on all charge accounts, installment accounts, and loans.

- Current bills include what you owe the dentist, this month's water bill, telephone charges, etc.

Now subtract—total assets minus total debts. That's your net worth.

Plan for a Yearly Overhaul

Even the best record-keeping system probably won't fill your needs forever. Changes in employment or your family's life style require some adjustments in your record-keeping requirements. At least once a year plan to review your files and do some housecleaning. January might be the best time for a record-keeping overhaul, since tax time will require you to look at your financial picture.

Additional Information

In recent years, a number of excellent books on financial planning have been published. Among the most popular have been Sylvia Porter's *Money Book*, Jane B. Quinn's *Everyone's Money Book*, and Venita Van Caspel's *Money Dynamics for the 1980's*. Each book contains information on record keeping and many other financial topics.

File: 3-5 Resource Management

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Net Worth Worksheet

What We Own	______, 19__	______, 19__	______, 19__
Cash on hand			
Checking accounts			
Savings accounts			
Money market funds			
Market value of house			
Other real estate (value today)			
Value of cars (if sold for cash)			
Furniture and appliances			
Jewelry, antiques, heirlooms (market value)			
Stocks (market value)			
Bonds (value now)			
Cash value of life insurance			
Cash value of annuities and other retirement plans			
Amount other people owe us			
Other assets			
Total Assets			

What We Owe			
Home mortgage			
Auto loan			
Installment debts			
Charge accounts			
Other loans			
Current bills			
Total Debts			

Net Worth			
(Total Assets minus Total Debts)			

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Money Mechanics | income taxes

Is your annual struggle with a federal income tax return something you put off for as long as possible and then cut corners to make the April 15 filing deadline? If so, you've made a costly mistake. Aside from income taxes, there are few areas of family financial management where a modest investment of time and effort pay such handsome dividends. No matter what your income or family situation, you are probably paying more taxes than you're legally obliged to pay.

This publication will help you spot tax overpayments and learn to take advantage of tax-saving strategies. The following information is not a substitute for an up-to-date, all-inclusive tax guide. You'll want to keep informed about yearly changes in the tax law and seek competent advice when needed.

Who Must File

If your income falls below the minimum levels, you may not need to file a federal tax return. In 1980, taxable income had to be less than the following amounts: $3,300 for a single person under age 65; $4,300 for a single person 65 or older; $5,400 for a married couple, if both are under age 65; or $7,400 for a married couple both 65 or over. There are some instances when your income will fall below these levels and you will still need to file a return. For example, any taxpayer with self-employment income of $400 or more must file.

Some persons will want to file a return even though they don't owe federal income taxes. If you had taxes withheld from your paycheck and your taxable income falls below the minimum income requirement, you'll want to file for a refund.

Filing Status and Tax Rates

The filing status you indicate on your tax return determines what rate will be applied to your taxable income. Choosing this status seems fairly straightforward, but many people make the mistake of checking the wrong box. Such an error could cost hundreds of dollars.

Figure 1 shows the tax rates which apply to income under each of the filing statuses. Note that income is taxed at a different rate depending on the filing status. Take a taxable income of $15,000, for example. Under the unmarried individual status, the tax would be $2,605. Under the head of household status, the tax would be $129 less.

The following questions and answers will help you figure out which filing status is most appropriate for you:

What determines marital status?

For tax purposes, you're considered married if the state you live in recognizes your marriage on or before December 31. You're considered single for tax purposes, if you are divorced or legally separated on or before December 31.

If a spouse dies during the tax year, the survivor is considered to be married for the entire year. If the surviving spouse does not remarry before the end of the year, a joint return may be filed.

Will married persons want to file joint or separate returns?

Married taxpayers may file a joint return listing all exemptions, income, and deductions of both persons. Even if one spouse has no income, a joint return may be filed.

Ordinarily, it is to a couple's advantage to file a joint return since the "split income" method is used to compute taxes owed. Tax is figured at a lower rate which applies to each half of the income rather than the higher rate which would apply to the total income. Married persons also can get special tax breaks when they file jointly, such as credits for child care expenses.

There are a few special cases where filing separately may mean you pay less tax than when you file a joint return. Maybe a substantial medical expense would give you a tax advantage when deducted from a single income rather than two incomes. In such cases, you may want to figure the taxes both ways to determine which approach results in a lower tax bill.

When does an unmarried person qualify as a head of household?

If you are not married (or are legally separated) at the end of the year, you may qualify as a head of household. You must have provided more than half of the maintenance cost of a household which served as a principal residence for a "qualifying relative" during the entire tax year.

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A qualifying relative is any related person considered a dependent for tax purposes– your unmarried child, grandchild, or stepchild, even though the child is not a dependent. If a parent qualifies as a dependent, and you maintain a home for them, you may file as a head of household.

Your Tax Bracket

No matter what your filing status, generally your income will not be taxed at the same rate. For example, in 1980 a married couple filed a joint return with a taxable income of $17,500. Refer to Figure 1 to see they paid $2,265 on the first $16,000 (or an average rate of about 14 percent). On the $1,500 of remaining taxable income, they paid tax at a rate of 24 percent (or $360).

This couple would be described as being in the 24-percent tax bracket. Note that 24 percent doesn't refer to the total percentage of the couple's income that goes for taxes. Only the amount over $16,000 is taxed at 24 percent.

Long and Short Tax Forms

The two most common forms for individual federal income tax returns are the short Form 1040A and the regular or long Form 1040. Most taxpayers can choose which form to use. Form 1040A doesn't allow you to itemize deductions. Form 1040 does. If you can qualify for enough deductions, it's to your benefit to use the regular Form 1040. It allows you to further reduce your taxable income and cut your tax bill.

In many cases, the Internal Revenue Service (IRS) will figure your tax if:

- your adjusted gross income is $20,000 or less ($40,000 or less if you are married filing jointly);
- your income was limited to wages, salaries, tips, dividends, interest, pensions, and annuities;
- you don't itemize deductions; and
- you mail in the signed return by April 15, 1981, for the 1980 tax year.

Married Individuals Filing Joint Return or Surviving Spouses

	Taxable income	Tax	% on excess
$0–	$ 3,400	$ –	–
Over	3,400	–	14
	5,500	294	16
	7,600	630	18
	11,900	1,404	21
	16,000	2,265	24
	20,200	3,273	28
	24,600	4,505	32
	29,900	6,201	37
	35,200	8,162	43
	45,800	12,720	49
	60,000	19,678	54

Married Individuals Filing Separate Returns

	Taxable income	Tax	% on excess
$0–	$ 1,700	$ –	–
Over	1,700	–	14
	2,750	147	16
	3,800	315	18
	5,950	702	21
	8,000	1,133	24
	10,100	1,637	28
	12,300	2,253	32
	14,950	3,101	37
	17,600	4,081	43
	22,900	6,360	49
	30,000	9,839	54
	42,800	16,751	59
	54,700	23,772	64

Unmarried Individuals

	Taxable income	Tax	% on excess
$0–	$ 2,300	$ –	–
Over	2,300	–	14
	3,400	154	16
	4,400	314	18
	6,500	692	19
	8,500	1,072	21
	10,800	1,555	24
	12,900	2,059	26
	15,000	2,605	30
	18,200	3,565	34
	23,500	5,367	39
	28,800	7,434	44
	34,100	9,766	49
	41,500	13,392	55
	55,300	20,982	63

Heads of Households

	Taxable income	Tax	% on excess
$0–	$ 2,300	$ –	–
Over	2,300	–	14
	4,400	294	16
	6,500	630	18
	8,700	1,026	22
	11,800	1,708	24
	15,000	2,476	26
	18,200	3,308	31
	23,500	4,951	36
	28,800	6,859	42
	34,100	9,085	46
	44,700	13,961	54
	60,600	22,547	59

Fig. 1. 1980 Tax Rates.

Taxable Income

Not all the money your family receives will be taxed. You do not have to pay income taxes on scholarships, federal income tax refunds, child support, gifts, welfare payments, Social Security benefits, workers' compensation, or life insurance proceeds.

Of course, earnings from an employer are taxable. At the end of the year you will get a Form W-2 from each employer you worked for during the tax year. It shows how much tax was withheld from your salary or wages. Copy B of each W-2 must be attached to your return as evidence of taxes you already paid.

Other examples of taxable income are income from rental property or a business you own, and profits on investments you sell (capital gains). Interest, alimony, and dividends (exceeding a certain amount) also are taxable.

Allowance for Exemptions

Each taxpayer is entitled to one personal exemption. A blind person or person 65 or older gets an additional exemption. If you file a joint return with your spouse, you get an exemption for each person.

In addition to a personal exemption, each of your dependents is worth another

exemption. Dependents are generally your children but may include anyone else you support. Even if a child with a part-time job claims a personal exemption on an individual return, you can claim the child as a dependent under certain conditions. Check the guidelines for claiming a dependent which accompany your federal income tax form. In 1980, the allowance for each exemption was $1,000.

Adjusted Gross Income

Some expenses can be subtracted from your gross income to determine adjusted gross income. Examples are:

- business expenses, including travel costs while you're away from home on an overnight, job-related trip
- moving expenses as a result of employment
- alimony (by the person who pays it)
- payments to retirement plans by self-employed persons

If you itemize deductions, the adjusted gross income figure is used to figure how much you can deduct for medical expenses and charitable contributions.

Deductions

There are two options for taking deductions: (1) take the zero bracket amount or (2) itemize deductions if the total exceeds the zero bracket amount. All taxpayers automatically get the zero bracket amount of deduction. In 1980, it is based on your filing status as follows:

Filing Status	Zero Bracket Amount
Married filing jointly or a qualifying widow or widower	$3,400
Single or head of household	2,300
Married filing separately	1,700

The zero bracket amount is incorporated into the tax tables. If your deductions do not exceed the zero bracket amount, you do not deduct or subtract this amount when computing your tax. However, if your deductions do exceed the zero bracket amount, you can subtract the excess deductions over your zero bracket amount from taxable income. You'll find it to your advantage to itemize deductions if you're paying on a home mortgage, have large medical bills, made large charitable contributions, paid significant state income taxes, or suffered a major uninsured loss.

It's difficult to tell which deductions will survive tax law changes from one year to another. Carefully check which of your expenses will qualify as a tax deduction each year. The more you can deduct from your taxable income, the fewer taxes you'll pay.

Tax Credits

After your tax bill is figured, you may be eligible for a credit. Credits are a dollar-for-dollar reduction in the amount of taxes due. Some tax credits available in 1980 are:

- certain expenses incurred to make your principal residence more energy efficient. You can get a 15 percent credit on the first $2,000 of certain expenses, with a $300 limit.
- child care expenses while you are employed. The credit is 20 percent of work-related expenses for care of a child under 15 or a dependent or spouse who is physically or mentally unable to care for himself or herself. The maximum credit is $400 for one child, $800 for two or more. In addition to traditional child care providers, grandparents or a household member who is not a dependent may be employed to care for a child or disabled person. These payments may be subject to Social Security tax or unemployment tax.

Tax Strategies

Timing your income and expenses can return hefty tax savings. One strategy involves the bunching of deductions in alternate years. In one year, keep deductions to a minimum and use the zero bracket amount. During the next year, maximize deductible expenses and itemize.

For example, let's say you usually give $100 to your favorite charity in December. Instead, postpone writing the check until January and then contribute again in December. In the first year you make no contribution. In the following year, you donate in January and December. Remember, expenses paid during a given year are deductible during that year, even if the person receiving the check does not cash it until the next year.

Another strategy involves avoiding a large "bulge" in income in a given year. For example, let's say you and your spouse are employed, but one of you expects to quit next year, which would significantly reduce your total income. Delaying other income until next year could mean tax savings. Perhaps collection of commissions or bonuses can be postponed until after January 1. Farmers might put off sale of livestock. Business owners could put off closing deals until the next year. Unfortunately, wage earners generally don't have this flexibility.

If your income increases substantially in any particular year, you may be able to compute your tax using the income averaging method. This method allows you to pay tax on your average taxable income over five years, instead of your high income for the current year.

You may use this method if your averaged income for this computation year is over $3,000 more than 30 percent of the total of your adjusted taxable incomes for the four preceding tax years. A complete discussion of income averaging is available in a free IRS publication 506 "Computing Your Tax Under the Income Averaging Method."

The most effective overall strategy for saving tax dollars is to make income taxes a year-round concern instead of a once-a-year drudgery. Plan your financial moves– your income, savings, spending, borrowing, and investing decisions– with tax consequences in mind.

Record Keeping

The IRS generally won't accept estimates of your deductible expenses. They want proof. The easiest way to provide that proof is to establish a record-keeping system for taxes. Such a system gives you the following advantages:

1. If you keep a running total of your deductions, it will give you a handle on your tax situation at all times and allow you to do more effective tax planning. You could adapt the form shown in Figure 2 called "Tax-Deductible Expenses" to keep track of deductions.
2. It will help you avoid overlooking or simply forgetting potential deductions.
3. It will cut down on your tax preparation time.

An easy way to keep tax records is to mark the letter T for taxes on every check stub you write for a deductible expense. Then, when you reconcile your bank statement, you'll be able to sort the cancelled checks into appropriate tax categories such as interest payments, medical expenses, charitable gifts, state and local taxes, and so on.

Doing this will also help you remember cash outlays that are deductible. For example, when you turn up a check to your doctor, you might also remember spending $5 on transportation to and from the clinic. Both expenses are tax deductible.

But, why leave things to chance? A simple little pocket diary or notebook is a good way to record all these incidental expenses that are deductible. Each expense may not seem too important. But at the end of the year, the grand totals of these "incidentals" can be sizable enough to reduce your tax bite considerably.

Date	Item	Business	Medical	Charity	Taxes	Other
		$	$	$	$	$

Fig. 2. Tax-Deductible Expenses.

Where to Get Help With Tax Returns

If you have questions about your income taxes, the help you need will depend on the complexity of your tax situation. First, you'll want to read the mini-tax guide that comes with your return in the mail. It will get you acquainted with all the recent changes in the tax law. The IRS also has an all-purpose reference called "Your Federal Income Tax," publication 17, plus many other free pamphlets covering specific topics.

If your tax situation is more complex, you may want to pay for professional help. The advice and suggestions you receive may save you time, trouble, and money. Probably the best rule-of-thumb to remember about tax help is to choose a firm that has been open for business all year 'round. The tax preparer should be willing to tell you how the return was prepared and tell the IRS, without extra charge, if you get audited.

Other rules of warning when dealing with a tax preparer are:

- Never comply with a request to sign a blank tax return.
- Don't deal with a preparer who guarantees a refund.
- Don't deal with a preparer who suggests under-reporting your income or "creating" deductions.
- Make sure the tax preparer signs the forms, as required by law.

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Money Mechanics | buying a house

Home prices are high and keep getting higher. Related housing costs such as mortgage interest charges, taxes, insurance, and utilities continue to increase, too. Yet, many renters want to become homeowners– and many homeowners are ready for a different house. If you fit either category, what are your options? What can you realistically afford to spend on all housing costs? This publication can help you answer these questions. In addition, it provides a worksheet that you can submit to Iowa State University. You'll get back a computer-assisted analysis that pinpoints a range of feasible housing costs to fit your spending plan.

Advantages, Disadvantages

Home ownership makes a great deal of financial sense. In the past, a house has been the best hedge against inflation available to the average person. For instance, you can deduct property taxes and the interest portion of your mortgage payments from your taxable income. Paying off your mortgage is a form of "forced savings," too. A portion of each mortgage payment increases your equity. The build-up of equity can help you move toward future financial security. For many persons, there are personal benefits of home ownership, such as establishing roots in a community.

Disadvantages of owning a home should also be considered. A mortgage obliges you to large payments for a long period of time. If house payments take too much of your monthly income, there may not be enough money to meet unexpected needs. The money you have invested in a house is not yours the day you decide you need it. It can take several months to sell a house.

Consider All Costs

If you think home ownership is for you, stop and consider if you can really afford it. Avoid considering just the purchase price in your housing decision. It's possible that all the "other" costs of owning a home– taxes, insurance, utilities, maintenance, and perhaps, additional transportation costs– could equal or even exceed monthly mortgage payments.

If you are considering buying a house, a computer-assisted analysis can help you estimate the total cost of home ownership. The analysis will point out the added heating costs of a poorly insulated home; or it can show you that lower property taxes in one location may be offset by the additional transportation costs of commuting.

Answer the questions on the worksheet on the last page of this publication. Then tear off that page, fold it in thirds, tape it together, add a stamp, and mail. You will receive a computer printout indicating a price range of houses you can afford, the actual monthly costs for principal and interest payments, as well as estimates of other regular housing expenses. If you complete questions 7-9, the income tax benefits of home ownership will be estimated for you. All information provided will be kept strictly confidential.

Purchase Price Guidelines

In addition to information provided by the computer analysis, you can use one of these two basic guidelines to determine how much to spend for a house:

- Avoid a purchase price greater than 2 to 2½ times your annual gross income.
- Avoid a monthly payment of principal, interest, and taxes greater than one week's pay before taxes– or 25 percent of monthly gross income.

You may be able to safely adjust amounts upward if:

- both spouses have steady incomes.
- your other debts are quite small.
- you are certain your income will increase.
- you are willing to make sacrifices in your level of living. Can your family put off buying a new car or taking an expensive vacation?

The Down Payment

The down payment represents the initial amount of cash you must provide to buy the property with a mortgage. This amount generally ranges from a minimum of 5 to 20 percent of the sales price. For example, a 10 percent down payment on a $60,000 house would be $6,000. Before settling on a down payment amount, be sure you have enough money to pay for moving, closing costs, and any necessary remodeling or equipment to make the house livable.

Also be aware that lending institutions often charge "points," an additional interest cost for the borrower. One point equals one percent of the mortgage loan. For example, if four points are charged on a $50,000 mortgage, the lending institution will lend $48,000. But the borrower pays interest on $50,000. Shop carefully for a mortgage and choose the plan that charges the fewest or no points, all else being equal.

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Accumulating a down payment can be a tough requirement. Here are several ways to deal with the down payment obstacle:

- See whether the present owners of the house could help with financing. Investigate the options of assuming their mortgage or buying the house on contract. This will require help from your attorney to be sure your investment is protected.
- Save more of your current income. By tightening the purse strings on transportation, food, clothes, new furnishings, or recreation, you can accumulate the down payment over time. Payroll deduction of savings can help.
- Consider an insured mortgage– Veterans Administration (VA), Federal Housing Administration (FHA), or private– that can sharply reduce a down payment or even eliminate it.
- Put your assets to work. Cash in savings certificates or sell stocks. Sell a second car. But don't leave yourself without savings to cover closing costs or emergencies.
- Add additional income and save it until you have the necessary down payment. Every family member can pitch in until your short-term goal is reached.
- Consider buying a mobile home. Down payments will be lower because of the lower purchase price.
- Buy a house that's lower priced because it needs work. If you have the skills and are willing to do the work, fine. If not, hiring someone to remodel and repair increases costs.
- Borrow the down payment. (Note, this may reduce your chances of getting a mortgage.) Sources might include life insurance companies where you have a policy, or relatives.

Obtaining a Mortgage

The mortgage is the legal document used where real estate is pledged as security for a loan. The interest rate on mortgage loans can vary according to market conditions. Most mortgages have a fixed interest rate and are repaid in equal monthly payments. Basically, there are two variations of the standard mortgage available to young families.

One is the **graduated payment mortgage (GPM).** Payments in the early years of the mortgage are lower than would be required with a standard mortgage, but gradually rise for a set period of years, then level off and remain steady for the balance of the mortgage. The rate of monthly payment increases and the number of years over which the payments increase can be varied to meet individual circumstances. This mortgage has appeal for young families whose incomes can be expected to rise. However, total costs for a GPM will be more than for a conventional, fixed-payment mortgage.

The **pledged savings account mortgage** plan is a special type of GPM. Instead of applying the total down payment to the purchase price of the home, part of the money is put in a pledged, interest-bearing savings account. During the early years of the mortgage, funds are gradually withdrawn from the savings account to make up the difference between the lower mortgage payment made and the actual payment needed to amortize the loan.

The second variation is the **variable rate mortgage (VRM).** Interest rates on these mortgages can change within specified limits, depending on financial market conditions. When the interest rate moves up or down, so does the monthly payment. In some cases the borrower can extend the term of the loan when interest rates rise, instead of increasing payments. The initial interest rate and down payment requirements may be slightly less than for a similar conventional mortgage, but possible increases in future payments can be a disadvantage.

The **renegotiable rate mortgage (RRM),** sometimes called a "rollover mortgage," is a special type of VRM. The RRM is a loan written with a term of three to five years, but with a 25- or 30-year amortization period. When the term of the loan expires, the interest rate is renegotiated according to movements in financial market rates.

These new mortgage alternatives are being offered by only a small number of lending institutions in Iowa. Check locally for availability. Participating lenders are required to provide a disclosure statement which compares interest rates, dollar costs, and other terms of the alternative mortgage and a similar conventional one.

Financing Options

Figure 1 summarizes the various types of home financing available in Iowa. Note that the required down payment as well as the terms of financing vary considerably.

Other Housing Choices

If the traditional house doesn't fit your spending plan right now, consider the two options discussed below. Both may require a smaller initial outlay of money.

- **Condominium ownership** means you buy a living unit and gain joint ownership of common areas and facilities. Any type of structure, including the single-family house, may be a condominium, although most are attached units such as townhouses or apartments. Condominiums offer some of the conveniences of renting and at the same time permit some of the economic advantages of ownership. Ask about monthly maintenance fees for the care of common property areas. Have your attorney check any bylaws or rules drawn up by the homeowners' association or management.
- A **mobile home** offers ownership and privacy at a relatively low price. It solves the housing dilemma for many, especially those with moderate budgets and small families. In addition to the home itself, a lot must be purchased or rented. A mobile home usually depreciates (loses value) over time. However, if it is well kept and located in a good neighborhood, the value may appreciate. Compared to a home mortgage, the interest rate will be higher and the term will be shorter on mobile home loans.

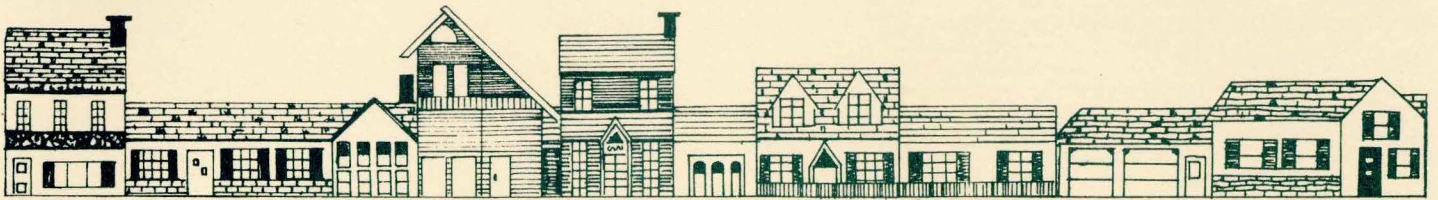
Investigate, Then Invest

The decisions you make about housing represent substantial investments– probably the largest you'll make in your lifetime. Make your decisions only after extensive investigation. Realistically consider total housing costs, financing arrangements, and housing alternatives. You'll be much happier with your housing decision in the long run, if it reflects both your needs and your financial situation.

ISUP 84-A1-1333

Fig 1. Alternatives available for financing a house.

Type of Financing	Down Payment	Term	Interest Rate	Income Limits	Mortgage Limits
Conventional Most common type of mortgage; obtain through bank or savings and loan institution.	20% or more, depending on lender's policy	Up to 30 years	Varies with market conditions and down payment (1980 range = 11-16%)	None	Determined by lender
Conventional-Insured Useful for buyers who can't afford down payment for conventional loan; same as conventional, except buyer pays additional insurance premium.	5 to 10%	Up to 30 years	¼% higher than conventional for private mortgage insurance	None	Determined by lender and mortgage insurance company
Federal Housing Administration (FHA) Useful for buyers who might not qualify for conventional loan. Available through participating lending institutions; buyer pays additional insurance premium to FHA.	3% of first $25,000 and 5% of amount over $25,000	Up to 30 years (35 years in some cases)	Varies with market conditions (1980 range = 11½-14% plus ½% FHA mortgage insurance premium)	None	$67,500
Veterans Administration (VA) Available to qualified veterans and unmarried widows of veterans through participating lending institutions or directly from VA if not offered locally.	As low as nothing down depending on price and appraisal	Up to 30 years	Varies with market conditions (1980 range = 11½-14%)	None	$100,000
Farmers Home Administration (FmHA) **General guidelines:** Available to eligible persons in rural areas under 10,000 population (20,000 in some cases) who cannot obtain credit elsewhere.	As low as nothing down, depending on income and appraisal value	Up to 33 years	As low as 1% depending on income	Adjusted gross income (gross income minus 5% and minus $300 per child)	Modest cost and design, depending on family needs
Specific guidelines by income brackets: Low to moderate income	Use available resources	Up to 33 years	As low as 1% depending on income	$11,200 (adjusted gross income)	Applicant repayment ability
Moderate income	Use available resources	Up to 33 years	Varies with market conditions (1980 range = 11-13%)	$11,200 to 15,600 (adjusted gross income)	Applicant repayment ability
Iowa Housing Finance Authority Available intermittently through participating banks and savings and loan institutions; two types available: FHA or VA. Due to recent federal legislation, funds may not be available in 1981.	Same as FHA, VA	Up to 30 years	Varies with market conditions (1980 rate = 8%)	$20,000 adjusted annual income; limited to persons who haven't owned home in past 3 years.	90% of average purchase price in country
Contract for Deed Loan negotiated between seller and buyer; upon completion of contract, seller promises to give deed to buyer; buyer has less protection than with mortgage financing– legal advice strongly recommended.	Negotiated with seller, usually less than conventional	Negotiated with seller	Negotiated with seller, usually similar to conventional interest rate	None	Determined by seller
Mortgage Assumption Attractive to buyer if seller has lower interest mortgage (and if this rate can be retained) with substantial balance to repay; buyer must be approved by seller's lender before mortgage can be assumed.	Difference between purchase price and mortgage amount (plus assumption fee– varies by institution)	Remainder of seller's mortgage	Same as seller's mortgage on FHA or VA; as lender negotiates on conventional	None	Balance of seller's mortgage



What's Your House-Buying Power?

Directions: Be sure to answer every question. Tear off this sheet, fold it in thirds, tape together, add a stamp, and mail.

Name ____________________

Street or Route ____________________

Town or City ____________________ State ____________________ Zip ____________________

County ____________________ Telephone ( ) ____________________

Income Information:

1. Gross annual income from wages and salaries of all household members (if it will be used to qualify for purchasing a home).

   a. $____________________ Earner A

   b. $____________________ Earner B

   c. $____________________ Earner C

2. Other dependable annual income that could be used to make mortgage payments.

   $____________________ other income

Other Information:

3. What is the likely location of the house you plan to buy in Iowa?

   a. ____________________
   city name

   b. location:
   _____ 1. inside city limits
   _____ 2. outside city limits

   c. ____________________
   county name

   d. ____________________
   school district name

4. If you bought a house in this location, how many miles would all drivers in your household drive each week? (To work, to school, and/or to shop. Do not include business mileage that is reimbursed or vacation mileage.)

   ____________________ miles

5. What type of heating fuel would likely be used in the house you plan to buy? (If unknown, indicate fuel used to heat present home.)

   _____ 1. natural gas
   _____ 2. LP gas
   _____ 3. oil
   _____ 4. electric resistance
   _____ 5. electric heat pump
   _____ 6. coal
   _____ 7. wood

6. Would you also like to receive information about:
   a. legal aspects of home ownership? Yes _____ No _____
   b. features to look for when selecting a home? Yes _____ No _____
   c. tax benefits of homeownership? Yes _____ No _____

If (c) is answered Yes:

7. How many exemptions, including yourself, will you claim this year for federal tax-filing purposes?

   ____________________ number

8. What is your tax-filing status?
   _____ 1. single
   _____ 2. married filing jointly or separately
   _____ 3. head of household

9. Estimate the total amount you will spend during the coming tax year on:

   a. $__________ medical and dental (only the amount that exceeds 3% of your adjusted gross income)

   b. $__________ state income and sales taxes

   c. $__________ interest (not including mortgage)

   d. $__________ charitable contributions

Worksheet prepared by Mary H. Yearns, extension specialist, family environment (housing); Russ Pounds, extension economist; Cynthia L. Needles, extension specialist, family environment (consumer and management); and Christine Denzin, extension specialist, family environment (family economics and public policy).

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Money Mechanics | owning a car

Except for housing and food, many families spend more on transportation than on any other expense category. As new car and fuel prices continue to increase, it's evident that the amount you spend on the family car demands close scrutiny. This publication will help you figure out how much it takes to own and operate your car every year. It also gives guidelines for reducing those costs.

The Transportation Decision

Knowing the total cost of driving– both on an annual basis and per mile– can help you make transportation decisions. Here are some situations where a knowledge of car costs is helpful:

• Should you trade in your car? The cost of driving your present car compared to the estimated cost of driving a different car can help you answer that question. To make the calculation, you'll need to assume what type of car you would buy, plus the costs of financing, insurance, and license fees.

• If you use your car for business, for moving to a new job, doing charitable work or visits to a doctor, this mileage is an itemized deduction. Should you use the Internal Revenue Service (IRS) flat deductions or calculate the actual cost of driving your car? (Note, the flat deductions can be far below the actual mileage costs of many cars.)

• Does it pay to drive across town to buy something on sale? For example, if it's a five-mile round trip to a store advertising a sale item, does the savings justify a trip that may cost $1.50?

• Would you save money by joining a carpool or taking a bus? If so, how much? (Figure 1 will help you make an estimate.)

Figuring Car Costs

How much do you spend each year to run your car? Use the "Car Cost Worksheet" on the next page to find out. Refer to these guidelines to make your calculations:

A. **Depreciation**, or the decline in value as the car ages, generally is the largest single cost of owning a car. The rate of depreciation is based on what you paid for the car minus what you'd get if you sold it. The resale value depends mostly on the age of the car.

Depreciation costs can be estimated using some average percentages. A new car will depreciate an average of 25 to 30 percent the first year, 18 percent of the new car price the second year, 14 percent the third year, 11 percent the fourth year, 9 percent the fifth year, 6 percent the sixth year, and 2 percent the seventh year. Thus, the car is worth about 15 percent of its original price after seven years of

Round-trip commute (in miles)	Annual savings per person from a:	Vehicle Type: Subcompact (29 mpg)	Vehicle Type: Standard (15 mpg)
10	2-person carpool	$ 9.50	$ 15.70
	3-person carpool	12.60	20.90
	4-person carpool	14.20	23.50
15	2-person carpool	14.20	23.50
	3-person carpool	18.90	31.40
	4-person carpool	21.30	35.31
25	2-person carpool	23.60	39.20
	3-person carpool	31.40	52.30
	4-person carpool	35.40	58.90
40	2-person carpool	37.80	62.70
	3-person carpool	50.30	83.60
	4-person carpool	56.60	94.10
60	2-person carpool	56.60	94.10
	3-person carpool	75.50	125.40
	4-person carpool	84.90	141.10

Figure 1. Monthly savings from carpooling. Figures include fuel at $1.40 a gallon and the cost of oil, tires, maintenance, and repair. Developed by Christine Denzin, extension specialist, family environment (family economics and public policy).

Prepared by Cynthia L. Needles, extension specialist, family environment (consumer and management), and Jane Schuchardt, communication specialist– home economics.

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ownership. So if you paid $6,000 for a car, depreciation costs would be approximately $1,500 to $1,800 the first year, $1,080 the second year, $840 the third year, etc. Not all cars depreciate at the same rate. Certain foreign cars and cars with good fuel economy tend to have high resale values. Check used car guides sold on the newsstand or available at many financial institutions for the current value of your car.

Besides using the percentage calculation, here is another way to determine this year's depreciation cost: Find out the current value of your car. Subtract that amount from the original price. Divide the remaining amount by the number of years you have owned the car. This is the average annual cost of depreciation.

B. **Interest costs** on a car loan add to the cost of driving. Multiply your monthly payment by the number of months of your loan. Subtract the net amount of the loan. Divide the remainder by the number of months of the loan. Multiply by 12 to get an annual figure to insert on line B.

C. **Licenses and registration** paid annually are totalled on line C. For most drivers this includes yearly registration fees for the car as well as the driver's license.

D. **Insurance premiums** must be totalled for the whole year. If you insure more than one vehicle with the same company, make sure you separate the charges for each car.

E. **Repairs, maintenance, and tire costs** can be taken from your financial records, or you can use an estimate. A major car rental company estimates these expenses average $318 annually for a car driven 15,000 miles a year for the first three years of its use. This figure includes service, repairs, tires, batteries, spark plugs, and other maintenance items. Repair costs can vary considerably depending on the car's age, miles driven, and the "do-it-yourself" skills of the owner.

F. **Parking fees, garage rental, traffic tickets,** and other miscellaneous bills can add up over a year. Past expenses are your best guide.

G. **Fuel costs** can be figured as follows: Divide the estimated number of miles you drive in a year by the number of miles per gallon (mpg) that your car gets.

Your Calculation:

__________ ÷ __________
(Total miles driven annually) (Miles per gallon)

= __________
(Gallons used)

Multiply that amount by the average cost of a gallon of fuel during the year. The result is your annual fuel bill.

Your Calculation:

__________ × $ __________
(Gallons used) (Price per gallon)

= $ __________
(Total gasoline costs)

Example: 10,000 ÷ 20 = 500 × $1.40 = $700

Total annual costs of driving a car are made up of fixed and variable costs. Generally, depreciation, interest, license, and insurance costs will stay about the same regardless of the number of miles driven. The expenditures for repair, maintenance, and fuel increase as more miles are driven. Consequently, high-mileage drivers will spend less per mile on fixed costs, but increased variable expenses will make their annual costs higher.

A fixed cost not included in the worksheet is the interest you could have earned by taking the money spent to purchase a car with cash and investing it instead. The more you spend for a car, the greater the cost of this "foregone interest." For example, assume you purchase a car for $6,000 and keep it for three years. If you had kept the $6,000 in a 6-percent savings account for three years, $1,200 interest would have been earned– or an average of $400 would have been earned each year. If, instead, you

Car Cost Worksheet

Add items A-G to determine the annual cost of owning and operating your car. Divide this figure by the miles you drive each year to estimate the cost per mile.

Item	**Amount per year**
A. Depreciation	$ __________
B. Interest on car loan	$ __________
C. Licenses and registration	$ __________
D. Insurance	$ __________
E. Repairs, maintenance, tires	$ __________
F. Parking, tickets	$ __________
G. Fuel	$ __________
Total annual costs	$ __________

$ __________ ÷ __________ = __________
(Total annual cost) (Mile driven in a year) (Cost per mile to drive your car)

Adapted from Continental Illinois National Bank and Trust Company of Chicago. "Counting Car Costs: A Driving Need." **The Family Banker.** July/August 1979.

purchase a used car for $3,000 and keep it three years, you would forego an average of $200 in interest each year.

Cutting Costs: Carpool

Driving alone is an expensive way to travel. Commuters who share the ride can cut costs considerably. How much you save depends on how many miles you commute each year, the type of vehicle you drive, the number of people in your carpool, and the price of fuel.

Figure 1 on the first page shows the monthly savings from carpooling if you commute 250 days during the year. The dollar estimates assume fuel prices of $1.40 per gallon and include the cost of oil, tires, maintenance, and repairs. Subcompacts are assumed to average 29 miles per gallon of gasoline, while standard-sized cars are estimated to average 15 miles per gallon. Your actual costs will vary with the efficiency of your car.

Cutting Costs: Keep Car Longer

Driving your car longer or purchasing used rather than new cars can save dollars. Most consumers don't buy new cars. In fact, almost 75 percent of all cars sold in 1979 were used. The reason is simple. Used cars are considerably cheaper to own and operate than new ones. Purchase prices for used cars one to four years old range from 20% to 80% below those of new cars. Savings on operating expenses are up to 50% below those typical for new cars.

The longer you keep a car, the cheaper it gets to drive per mile. A report by the Hertz Corporation, a major car rental business, says the average annual cost of driving a typical new compact is 40 cents per mile, or $4,000 per year. This assumes you drive 10,000 miles annually, keep the car for three years, and finance two-thirds of the purchase price. Due to rising prices of fuel and other items, these figures go out of date even as they are calculated. Hertz reports the cost of owning and driving a new car climbed about 90 percent between 1973 and 1979.

In contrast, a three-year-old used car driven 10,000 miles a year and kept by the second owner for three years, costs about half as much to operate as a comparable new car. Maintenance and repair costs do go up as a car gets older, but those expenses tend to be lower than the depreciation on a newer car.

Whether you buy a new or used car, one that is more fuel-efficient will reduce operating expenses. Generally, a small car is cheaper to operate, insure, and service than a large car.

Cutting Costs: Routine Care

Day-to-day maintenance of your car helps to keep costs down. Keep the engine tuned, wheels aligned, and tires properly inflated. Minimize the use of air conditioners. Remove unnecessary items from the trunk. Mileage is cut 1 to 2 percent for every 100 pounds of added weight in your car.

Cutting Costs: Insurance

Review your automobile insurance. Increasing the deductible amount for both your collision and comprehensive physical damage coverage will reduce premiums. Any loss over $100 is deductible for income tax purposes. Collision insurance (coverage which pays for damages to your car) is important on a new car but may not be necessary as the car gets older. Consider dropping collision coverage when the car's value is so low you could handle the loss yourself. The company will not pay any more than the car is worth. That amount may be close to the cost of collision coverage. You might save the premium dollars to use to replace the car in the future.

Compare coverage and cost for auto insurance sold by several companies. Ask about special rates for which you may be eligible, such as ones for an accident-free driving record. Paying premiums annually or semi-annually will be cheaper than monthly payments. Do not let cost be your only consideration in selecting a company. Ask other consumers about their satisfaction with claims service before making a decision.

Dollar Watch

As the costs of buying, financing, and operating a car continue to climb, it becomes more important to watch what share transportation takes in the family spending plan. By knowing just how much it does cost to drive those few miles to shop, to school and to work, you can make a conscious effort to reduce travel and save money.

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Money Mechanics | saving & investing

Before you consider an investment program, make certain you've covered the basics. Can you manage your current debt load? Do you have an adequate emergency savings fund? Does your insurance program meet your needs? If you've set a goal of owning a home, do you have the down payment? You may want to give careful consideration to a retirement program, even though that may seem far-off at the present time.

Saving Versus Investing

Saving is not the same as investing. In most savings alternatives, the initial amount of capital or cash remains constant and earns low, guaranteed rates of interest. The "fixed-dollar" feature of savings is in contrast to the "variable dollar" nature of investments. The initial amount of capital can increase or decline in value, and interest or dividends are not guaranteed.

How Much to Save

First, think through your reasons for saving and set specific goals. One goal may be to have some "rainy day" money put aside where it is readily accessible. Set the amount of this emergency fund at whatever makes you feel the most comfortable. A general rule is to have two or three months' take-home pay saved for this purpose.

Other goals may be more specific, such as replacing a car or financing a child's education. Calculate how much money needs to be put aside to achieve these goals. Figure 1 will help you determine how much to save each month to accumulate the necessary cash by a certain date.

For example, say you'll need $5,000 in five years to replace a car. You must put $74.40 each month in a 6 percent savings account to reach your goal in five years. If you want to have $10,000 accumulated in a college fund 10 years from now, you must save $54.86 monthly in a 9 percent account.

In order to achieve your goals, it's important to add to savings on a regular basis. One guideline is to save 10 percent of take-home pay each month. That goal may be unrealistic for many young families today. Perhaps saving 4 or 5 percent of your monthly income is more feasible. Once savings goals are met, excess funds can be moved from savings instruments to investments.

Tips for Saving

• **Pay yourself first.** Consider savings as a fixed expense similar to the house payment and utility bill. Put away some money before you do anything else with your paycheck. One alternative is to have an amount automatically deducted from your paycheck and put into a savings plan. If you wait until the end of the month to save, chances are there won't be anything left. Saving in regular, smaller amounts is usually more successful than putting aside larger amounts sporadically.

• **Save windfall income.** The theory is simple. You got along without the unexpected bonus, tax refund, overtime pay or gift, so why not keep on that way and save the extra money? A similar tip is to save monthly loan payments after a loan is repaid.

Total dollars needed	Years to achieve goal: 5	10	15	20
	At 6% rate of return			
$ 5,000	$ 74.40	$ 31.57	$17.88	$11.32
$10,000	148.81	63.13	35.77	22.64
$15,000	223.21	94.70	53.65	33.97
$20,000	297.62	126.26	71.53	45.29
	At 9% rate of return			
$ 5,000	$ 69.68	$ 27.43	$14.19	$ 8.14
$10,000	139.35	54.86	28.38	16.29
$15,000	209.03	82.29	42.57	24.43
$20,000	278.71	109.72	56.77	32.58

Figure 1. Monthly savings to reach a goal.

Prepared by Cynthia L. Needles, extension specialist, family environment (consumer and management), and Jane Schuchardt, communication specialist– home economics.

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• **Try frugality.** Cut out or cut back on eating out, entertainment, or pleasure drives. A period of frugality can help you save money quickly and perhaps eventually change your lifestyle. Once you adjust to a "no-frills" spending plan, add back just a few of your previous expenses. You may discover others weren't really necessary. Living frugally may be more satisfying than continuing past habits that left few dollars at the end of the month.

Where to Save

Once you have decided how much to save, the next question is where. Savings options generally are characterized by low risk on the principal, high liquidity, and fixed, guaranteed returns. Listed below are common savings alternatives.

• **Savings accounts and certificates of deposit.** Institutions such as commercial banks, savings and loan associations, or credit unions offer the safest alternatives for saving. However, the rate of return is low— often well below the rate of inflation. Certificates of deposit, which require a larger initial investment than a savings account, yield a slightly higher return. To get the higher return, the money must be kept in the account for a specified period— usually six months or longer. If you plan to put money into several certificates, it may be to your benefit to stagger maturity dates.

• **U. S. government securities** offer low-risk savings options. Series EE and HH savings bonds, Treasury bills, notes, and bonds, and federal agency bonds reach maturity within a stated number of months or years. Interest yields and minimum investments vary widely among these alternatives. Contact your financial advisor, banker, broker, or the nearest branch of the Federal Reserve for more information.

• **Money market mutual funds** generally provide good interest returns and liquidity. The funds, which were first offered in the early 1970's, are pools of money invested in bank certificates of deposit, U. S. securities, and other instruments. The funds are managed by private corporations that charge a small annual fee for their services. There generally is no commission charge (referred to as no "load") for making deposits. Initial minimum deposits are commonly $1,000 to $2,500. Interest is compounded daily.

Money market funds are different from other types of savings alternatives. The rate of return varies, depending on the earnings from the fund's investments. Deposits are not federally insured, although the investments are generally quite safe. To the extent that the monies are held in U. S. securities, there is no risk of loss. Most funds offer a free check-writing privilege. There is often a minimum check limit of $500.

Evaluate Savings Options

No particular savings alternative is "best" for a particular family. Maybe a combination of options would help you meet your savings objectives. Some characteristics about a savings option may be more important to you than others. To help you find out, here are some questions to consider:

- Is the principal safe?
- Is the return guaranteed?
- Can funds be withdrawn without penalty or loss of interest?
- How will inflation affect the purchasing power of dollars saved?

Remember, no single savings option will meet all of these considerations.

Investment Objectives

The first step in investing is to identify your investment goals. Do you want more income right now? How much time do you have to meet your objectives? Do you want fairly reliable growth of capital or are you willing to be speculative? What degree of risk will you accept? Speculators are investors who take great risks in order to earn high returns quickly. More conservative investors make money grow over the long haul with a diversified, high-quality investment program.

Choosing an Investment

There are many investment alternatives. You'll want to investigate each one completely before choosing the best ones for you. Figure 2 compares the characteristics of several common investment alternatives. Seven criteria, as described below, are considered:

Degree of Risk

Whenever you make an investment, there's the risk that you won't make any money and you might even lose the principal. Saving instruments insured by the Federal Deposit Insurance Corporation (FDIC) or the Federal Savings and Loan Insurance Corporation (FSLIC) are about as safe (risk-free) as any alternative. In comparison, consider an investment of stock in a small company whose future depends heavily on an upswing in the economy. Certain events might lead to bankruptcy or a dramatic increase in the stock's value. In general, the greater the risk, the greater the prospects for a higher return.

Another type of risk is psychological. Declines in the capital value of your investment may be depressing and result in sleepless nights. If the risk of emotional stress is too great, you may want to avoid making variable dollar investments.

There are two ways to minimize risk: First, you can become more knowledgeable about investment alternatives; and second, you can diversify your investments.

Rate of Return

Returns are usually expressed as an annual percentage rate of the original investment. The total return from an investment includes earnings from the principal plus growth of principal.

For example, assume that $1,000 was invested in 10 shares of common stock paying 6 percent cash dividends each year. After 10 years, earnings from the principal would be $600. If the stock is then sold for $1,500, the total return would be $1,100— this represents $600 from dividend earnings and $500 from growth of principal— or 11 percent average annual return. A $300 capital loss on the stock sale would result in a $300 return over the 10 years or a 3 percent average annual return.

Liquidity

Liquidity is the ease with which an investment can be converted to cash. For example, savings accounts are liquid assets, but an investment in real estate generally is not. It can take considerable

time to sell property. Funds in stocks or mutual funds are liquid assets and can be traded anytime. However, the market price may be depressed at the time you need the cash.

Management Requirements
Certain investments take time and skills, such as personally managing an apartment building or a portfolio of common stocks. For these investments, you can hire a professional manager. Other investments require little time or skills after the initial investment decision is made.

Maturity
Many investments take a certain time period before reaching the expected rate of return. Certificates of deposit, often called "time" certificates, are an example. Other investments such as real estate or common stocks won't have a specified maturity date, but time is needed to generate earnings and increase the capital value.

Inflation Hedge
The degree of protection an investment provides against inflation is an important consideration. Equity investments— where you own something such as common stock or land— historically have shown a growth of principal which has outpaced the rate of inflation.

In contrast, putting your money in bonds, a savings account, or a cash-value life insurance policy typically offers a fixed rate of return but no increase in the value of the principal.

Tax Consequences
Returns from investments are taxed either as income from the principal or as growth of the principal. Income from the principal— except the first $100 of ordinary dividends received from qualifying corporations— is added to an investor's ordinary income and is taxed. Certain income referred to as "dividends" from credit unions or savings and loan associations is interest income for tax purposes. It is not covered by the $100 dividend exclusion.

In 1981 and 1982, the first $200 of dividends and interest, totaled from all sources, including savings, will be exempt from federal income taxes. Up to $400 will be exempt on a joint return.

The growth of principal is taxed as capital gains income in the year the investment is sold. Qualifying capital gains income is taxed at a lower rate than ordinary income. Ask a tax advisor for more information.

The higher your tax bracket, the more attention you will want to give to the tax consequences of an investment. Persons in high tax brackets minimize tax liability by seeking tax-exempt investments or those providing long-term capital gain income.

Seek Advice

The adage "investigate before you invest" is old, but not out-of-date. Consider these sources:

• The library has extensive information on saving and investing. Newsletters, periodicals, and magazines are frequently located in a special business and finance section. Research the company and the type of investment you are considering. Look at past performance, current financial standing, and future prospects.

• A reputable brokerage house or advisors at your financial institution are good sources of information. It's your job to take that information, examine it, and make your own decision based on your goals.

If an investment opportunity sounds too good to be true, it probably is. Check with the Consumer Protection Division of the Iowa Attorney General's office (1300 Walnut, Des Moines, Iowa 50319) to see if there have been any complaints against the company. The phone number is (515) 281-5926.

Investment type	Degree of risk	Average annual return	Liquidity time period	Management required	Maturity period	Inflation hedge	Tax consequences
Common and preferred stock	Moderate to substantial	Variable	Short	Moderate to substantial	May be sold at any time	Variable, generally good	Dividends taxed as ordinary income. Capital gains taxed on sale
Mutual funds	Moderate to substantial	Variable	Short	Little	May be sold at any time	Variable, generally good	Same as above
Business Ownership	Moderate to substantial	Variable	Moderate to long	Moderate to substantial	Moderate to long	Variable	Some income sheltered by depreciation. Capital gains taxed on sale
Real estate	Variable	Variable	Moderate to long	Moderate to substantial	Moderate to long	Generally good	Same as above

Figure 2. Comparing selected investment alternatives. (Adapted from North Central Regional Extension Publication No. 49. Retirement Planning for Farm Families, 1976.)

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