

MoneyWise Workshop Module 2: Financial Freedom: Living Beneath Your Means

Introduction

Our topic is “Financial Freedom – Living Beneath Your Means”. Here we discuss important topics regarding income, spending and saving. These are critical topics if we are to accomplish the purposes that God would have us accomplish through personal finance.

Objectives

The objectives for this section are:

1. Financial perspective
2. Maximize income
3. Reduce spending
4. Start saving
5. Eliminate inappropriate debt, and
6. Bank wisely.

We will address these issues in this second module.

Lending Tree Videoⁱ

Many of you have seen this or similar advertisements. Someone is in debt due to choices they have made in the past, and they are seeking help. If it wasn't so funny it would be really sad! But the amazing thing is that there are so many people out there in that situation. I don't know if it's because they haven't been taught, which is lack of education, or they haven't been able to discipline themselves, which is making poor choices. Either way, the key is not in what we say, but in what we do.

1. Financial Perspectives

Contrary to popular belief, in most cases financial problems are behavioral problems, not money problems. Someone commented about money: “Earn five dollars, spend six, misery; earn five dollars, spend four, happiness”. I know it is a simple, but there's a lot of truth in that sentence. We all know what we should do. We know we should live on a budget, spend less than we earn, not go into debt, save for long-term goals, teach our children, etc. But in many cases we do not

do what we know we should. The easy part is the math, income minus expenses equals savings. The harder part is the behavior, the personal part. The question becomes how do we motivate ourselves and others to make better financial choices?

Boyd K. Packer gave us guidance when he said “True doctrine, understood, changes attitudes and behavior. The study of the doctrines of the gospel will improve behavior quicker than a study of behavior will improve behavior”.ⁱⁱ

The key is to understand doctrine, that personal finance is simply part of the gospel of Jesus Christ. And as part of that gospel, Christ wants us to live on a budget, spend less than we earn, not go into debt, save for long-term goals, teach our children, etc. He knows that doing these things will bring us peace in our lives and will teach us important lessons to help us become more like Him.

For example, if debt is a problem, then if we are able to come closer to the Savior, we will realize that He wants us to get out of debt and He will help us do it if we seek His help. Ezra Taft Benson explained the difference between the world’s view and the Lord’s when he said:

The Lord works from the inside out. The world works from the outside in. The world would take people out of the slums. Christ takes the slums out of people, and then they take themselves out of the slums. The world would mold men by changing their environment. Christ changes men, who then change their environment. The world would shape human behavior, but Christ can change human nature.ⁱⁱⁱ

2. Maximize Your Income

The next topic is to maximize income. You need to gain the education and learn those skills that you enjoy and that the world is willing to pay you to do. It is important that your job skills include both areas.

Income is an interesting topic. Money you get in the future is worth less than money you save and can invest today. Money you save today is worth more as it can be invested to earn you more money (i.e., compound interest). I have found that earned money is harder to spend than borrowed money. Once you save money, you know how difficult it is to save, and it makes you more careful with your money.

There is a tradeoff between borrowing, working, and saving. You could borrow \$24,960 in student loans for a four-year degree. Or you could work 15 hours a week at \$8 an hour for 52 weeks for 4 years to save that same \$24,960 and leave school debt free. Or you could put that same money in a Roth account and assuming an 8% return on your investment have \$29,390 at the end of that 4 year period. The key is to be wise about what you do.

Increasing Your Earning Power

We have five recommendations for increasing your earning power.

1. Be good at what you do. When you leave school and are in the work force, strive to be the very best you can be. You are not taking a job just for the money, but so you can feel good about the work that you do and contribute to the success of the organization. To increase your wages, increase your contribution to the company. For this, education is the key. Keep learning, stay abreast of developments in your field, and remember the only insurance you have is your abilities and relationships.

2. Be a problem solver. Work to help your company be successful in their correct goals. Continue to learn to help you be the best at what you do. Pray each day for guidance from Heavenly Father to help you work beyond your natural abilities. He gave you your abilities and He can help you work beyond them.

3. Understand what drives your business. The way to add value to your company and improve your skills is to determine what drives your business. What are the key determinants of business success? Work to understand all areas of your business including clients, technology, production, suppliers, finance, etc. As you understand your company and industry, it will be easier to add value in whatever area you are working.

4. Have mentors in your field. Realize that to be the best in your area requires help. Work to develop relationships in your chosen field. If possible, develop mentors who can help you to understand your industry and company and to help you be the best employee (or employer) you can be.

5. Network. One of the most important networks are the friends you have here. Continue to work with and help others as you develop your network of acquaintances and friends.

3. Reduce Spending

You cannot spend your way to financial security (regardless of what the government tries to do). Thankfully, you are not the government. You can make choices and you are accountable for those choices. There are a number of roadblocks to wise spending. They are:

1. Lack of specific savings goals. It is easier to save if you have a goal for that savings. Think about why you are saving? Determine how much money you will need to save to retire as you would like, then begin saving NOW.

2. Poor record keeping. This is a major problem for many people. Most people don't realize how much they spend. They generally overstate their income, and understate their

expenses. Experience has shown that the average person cannot account for 20% of their spending at month end. Be better than that and keep good records.

3. Easy credit. Easy credit has been a problem for many. If the bank is willing to lend me all this money, shouldn't I take it? Remember the purpose of this easy credit is not to be nice to you but to have you paying fees and interest for as long as you possibly can.

4. Stress. Have you ever noticed that when you're tired you spend more than when you're rested? Plan for this. Never go to the grocery store hungry and never buy things not in our budget and which have not been planned for.

5. Entertainment spending. While I realize that a date each week is a fixed expense, and not a variable expense (my wife taught me this), make sure that entertainment spending fits into your budget and is consistent with your goals and objectives.

6. Inappropriate debt. President Ezra Taft Benson said: "The Lord desires his Saints to be free and independent in the critical days ahead. But no man is truly free who is in financial bondage."^{iv} A good friend commented: "Debt is the enemy to growth."^v If you're in debt, can you grow your savings? And it's not only the enemy to both temporal growth but to spiritual growth as well. I know lots of people who would never think of not paying their tithing. However, they get so far in debt that they almost need that money to make their minimum payments. You can't spend your way into financial freedom.

See Through the Marketing Hype

See through the marketing hype:

1. The 9's. Any idea why you always have these 9's the price? It's because we think that's a better deal because it is not quite the full dollar.

2. Low monthly prices. What about the low monthly price, \$15 per month? That sells things because you become distracted you from the overall amount you are paying. Often the interest costs will be more than the cost of the product.

3. Free hot dogs and drinks. What a great idea—a free lunch. But its purpose is to get you into the store so you will buy things. You will not buy anything if you're not in the store.

4. Once in a life-time savings, and free delivery. Without a significant markup in the cost of the products, the store cannot deliver them and make a profit.

Be wise to this hype and don't fall for these tricks. When we have purchases to make, the Lord wants us to be wise stewards, to plan for our purchases, to study it out in our minds, to determine the relevant alternatives, and to make the best decision we can make.

The Real Cost of Consumer Credit

Be wise in your use of consumer credit, and avoid it. James E. Faust stated: "Over the years the wise counsel of our leaders has been to avoid debt except for the purchase of a home or to pay for an education. I have not heard any of the prophets change this counsel."^{vi} Notice that credit card debt that is not paid off each month or auto loans are not included in this short list.

What's in an asterisk? Assume a stereo costs \$700, or \$750 with taxes. This purchase has an annual percentage rate (APR) of 21%, you will be paying for 120 months or 10 years. What is the real cost? The truth is that you will pay interest of \$1,050, more than the cost of the stereo. Wouldn't it be so much better if you paid cash for it and saved the interest?

Other Financial Traps

There are other financial traps as well.

- Payday Loans. These are short-term loans of 2 weeks with APR interest rates in excess of 500%. Avoid these like the plague.
- Free stuff. Watch these for the fine print. A free phone looks good until you realize that you have to have a two year contract and pay \$50 per month. A free dinner for a seminar is really a sales pitch for a specific product.
- Rent to own. These companies make huge profits because the items they "rent to own" are priced much higher than you could buy them elsewhere. Avoid these places.
- Leasing cars. While a new car every three years seems nice, realize dealers like leases because they can lease you a new car every three years and keep you paying huge lease payments. Compare the overall cost of buying versus leasing. I recommend you keep them for 10 years or 200,000 miles and you will save a lot in transportation expenses.
- Tax refund bonanza. Some people go out and spend their refunds before they have it, and even sometimes before they know the total amount. Save a big chunk of these "benefits" to increase your savings.
- Extended warranties, extras. Avoid extended warranties on small purchases of electronics, appliances, and perhaps even automobiles. Occasional you will pay for repairs, but if you take care of things you will be better off in the long run. A good rule of thumb is to only insure against losses that could be catastrophic.

Don't Buy Stuff You Can't Afford Video^{vii}

This Saturday Night Live video is one of my favorites on living beneath our means. We need to be wise in what we spend and save for our purchases.

Ownership is Stewardship

Too often when buying things, we fail to look at all the overall cost. We think the cost of the car is just the purchase price, tax, and license fees. We forget about the maintenance, tires, insurance, depreciation, storage, gas, and most importantly the opportunity costs. As you begin to accumulate stuff, you realize the validity of the statements “When you first start you own things, but after a while, things own you”.^{viii} When you look at things you’re going to buy, realize ownership is stewardship. You’re stewards over what you have and you need to take care of those things.

4. Start Saving

Savings are important if you are to reach your personal and family goals. We can tell what we value most in life by where we put our time. Are we spending time with our families? Are we spending time going out and serving the Lord’s children? Are we doing the things our Heavenly Father would have us do? I like the scripture in which says “Wherefore, do not spend money for that which is of no worth, or your labor for that which cannot satisfy. . . Feast upon that which perisheth not, neither can be corrupted, and let your soul delight in fatness”.^{ix} Note that it doesn’t say “unless you can afford it”, or “unless you get approved”. You may get to a point in your life where you decide other things are more important than money.

Pay Yourself Second

We have talked about how we pay the Lord first. Most are comfortable with this recommendation. Now learn to pay yourself second. L. Tom Perry said

After paying your tithing of 10 percent to the Lord, you pay yourself a predetermined amount directly into savings. That leaves you a balance of your income to budget for taxes, food, clothing, shelter, transportation, etc. It is amazing to me that so many people work all of their lives for the grocer, the landlord, the power company, the automobile salesman, and the bank, and yet think so little of their own efforts that they pay themselves nothing.^x

Think more of your efforts and pay yourself second. In the Personal Finance class taught at BYU, I recommend to students that I want them to save 20% gross of every dollar they make after college for long-term goals (education, retirement, missions, etc.). Paying yourself is not going out and buying that DVD player or the new iPhone 5 or buying a new car, it is saving for you and your children’s missions and education, and saving for retirement.

Saving: the Old Way

The old method of saving was with your budget; you paid the Lord and then paid your expenses. Then anything left over went into savings. The problem with most people who follow this process was that there was never anything that was left over at the end of the month--it was all spent.

Saving: the Better Way

The better method of saving is that you pay the Lord first and then pay yourself second. Now you have twice the chance of accomplishing your goals. Another benefit of this is once you pay yourself, your bank account drops, and you realize you have less to spend for your expenses and you act accordingly.

Debt: Appropriate Versus Inappropriate Uses

There are two different types of debt: appropriate and inappropriate. Appropriate debt is the type of debt that the prophet and the apostles have said it's ok to go into debt for: a modest home and an education.^{xi} Those are what we call appreciating assets, things will likely continue to add value over time. Then we've got depreciable assets such as cars, toys, entertainment sets, these are actually things that will lose value over time. It's called consumer or "bad debt". Wise stewards are those who spend more on the appreciating assets and spend less on depreciating assets.

Debt: Putting Savings to Work with Debt Elimination

So you have made poor choices in the past and are in debt. How do you get out of debt? There are a number of different debt elimination tools on the personal finance website at <http://personalfinance.byu.edu> that can help you. They can show that if you pay your minimum payment and then you pay a certain dollar amount of an extra payment, you can pay it off your debt in a certain amount of time.

Some have found that even with these tools they still go into debt. If you find yourself continually going into debt, I recommend Jeffrey R. Holland's counsel to do some "plastic surgery."^{xiii} It may require you to cut up your credit cards. Our choices can make credit cards either an important tool to help accomplish your goals or the single most destructive tool in the history of mankind. We need to do is be wise and we need to get out of debt.

Debt: Opportunity Cost of Student Loans

Education debt is a different thing. Many students come out of school with debt, and they will likely earn more with their education so they can pay off their student debt quicker. The key is to pay off your student loans as quickly as you can.

Every time you make a financial decision, you are making a choice. For five dollars you could buy a date to a dollar movie (again, a fixed expense if you are married). You could also buy a power sized smoothie or you could put five dollars a week into a mutual fund for your retirement goal. Five dollars a week at an 8% interest rate after 40 years would give you over \$76,000. Realize we make financial choices every day. These choices either lead us closer to or farther from our personal goals, including our personal goal to get out of debt as the scriptures and prophets have counseled.^{xiii}

Let's discuss your repayment of Stafford loans. The key is to determine the real or total cost of the loan. Notice here that we borrow a dollar but we have to pay back that dollar plus interest. Assuming a 6.8% interest rate, repayment in 10 years and a 30% tax rate, you will not pay back \$1, but will actually pay back \$1.41 with principle and interest. And to earn that \$1.41, it will take \$1.83 of earnings after paying taxes of 30%. So for that \$1 of student loans, it will cost you \$1.83 or 83% more to pay back. So if you can reduce your spending and minimize the borrowing, you will be so much better off.

Student Debt Cautions

Let's add some student debt cautions:

Avoid alternative loans. Unlike Federal student loans, alternative loans have no interest rate caps, the interest rate changes quarterly, and rates can be double what the government charges.

Car loans. Be careful and remember the counsel from the prophet. Get into the habit of saving for your cars, instead of borrowing for them. Some people can't imagine a car without a car payment, while others can't imagine a car with a car payment.

Eliminate credit card debt. Make it a habit of living on a budget, paying the Lord first and yourself second, and of paying off your credit cards each month.

Financial Priority 4 – Pay Off Consumer Debt

Here is financial priority number four: pay off consumer debt. Think about the things you will do to pay off your consumer debt. What goals will you set? ? If you are in debt and you're not repaying in full, how are you going to get out of debt?

6. Bank Wisely

As you work to get your financial house in order, a good bank is helpful. If your credit is bad (the bank will do a credit check), look for an account with free checking and a debit card. If you have good credit, generally you can get free regular checking (where a minimum balance required), a credit and/or debit card, and overdraft protection. Most banks also have free statement savings accounts, internet banking, and online bill pay. If you are using Quicken or other financial software, check to make sure the bank is Quicken compatible and do not charge extra for online access. The key is to understand your needs and minimize your banking costs. Most of these things should be free.

Banking Tips and Tricks

Following are a few tips that the instructors have felt important:

- Young couples usually benefit from having one joint checking account, but you may need two! Determine your needs and then find a bank to fill those needs.
- Money market accounts are a good, safe place to put excess funds. Make sure the account is FDIC insured up to \$250,000. An FDIC internet money market account pays a little more interest than a regular money market account. Compare your Annual Percentage Yield (APY) between banks for the best rates.
- Balance your checking account each month to avoid overdrafts, ask your bank for help if you are not sure how. Keep your banking costs at \$0 if possible.
- If you use online banking services (bill-pay, etc.) be sure you can integrate that information with your budget.
- Finally, banks are usually not the best source for mortgages (this will be covered later in the course).

Summary

We have discussed many important things today. They were:

1. Financial Perspective. Most financial problems are behavioral problems, not money problems. We need to understand that Heavenly Father wants us to be wise financial stewards, and He will help us if we ask and follow His guidance.
2. Maximize Income. Find work you enjoy and that will pay you a decent income. Work to increase your earning power by being a better employee. Education is the key.
3. Reduce Spending. Avoid the numerous financial traps. Remember you cannot spend your way to financial freedom (you are not the government).
4. Start saving. The time to begin saving for your goals is now.

5. Eliminate inappropriate debt. Appropriate debt is for education and a modest home. All other debt is inappropriate including credit card debt not paid off each month and consumer and car loans.

6. Bank wisely. Determine your banking needs and then find a bank that can meet your needs at the lowest cost (preferably free)

ⁱ This video can be found at <http://www.youtube.com/watch?v=hn5EP9StlVA>.

ⁱⁱ Boyd K. Packer, "Do Not Fear," *Liahona*, May 2004.

ⁱⁱⁱ Ezra Taft Benson, "Born of God," *Ensign*, July 1989.

^{iv} Ezra Taft Benson, "Prepare Ye," *Ensign*, Jan. 1974, p. 69.

^v Jason Payne, *Financial Planner*, November 2012.

^{vi} James E. Faust, "Doing the Best Things in the Worst Times," *Ensign*, August 1984, 41.

^{vii} This video can be found at <http://www.youtube.com/watch?v=VL3KuaFvOSc> (0:34)

<http://www.hulu.com/watch/1389/saturday-night-live-dont-buy-stuff>

^{viii} Anonymous.

^{ix} 2 Nephi 9:51.

^x L. Tom Perry, "Becoming Self-Reliant," *Ensign*, Nov. 1991, 64.

^{xi} James E. Faust, "Doing the Best Things in the Worst Times," *Ensign*, August 1984, 41.

^{xii} Jeffrey R. Holland, "Things We Have Learned—Together," *Ensign*, June 1986, 30.

^{xiii} 2 Kings 4:7.