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Savings Basics

Your savings will give you the power to get what you want. It's important to get yourself into the savings habit, no matter what amount you can afford to save each month. Even small amounts will add up over the years.

The Basics of Savings Accounts

A savings account or share account at a credit union is a place to deposit money you don't plan to spend right away. This makes a savings account a good place for short to medium term financial goals.

Benefits

1. **Your money is easy to access.** Many types of savings accounts enable you to get cash out quickly and without penalty.
2. **Your money is working for you by earning interest.** Interest is the money your financial institution pays you so that they can use your money to fund loans for other people.
3. **Your money is safe and secure.** Financial institutions are responsible for keeping your money safe and giving it to you, with interest, whenever you ask. Your financial institution carries government insurance of at least \$100,000 to protect your deposits.

Opening a Savings Account

Opening a savings account is easy. Take cash or a check made out to the financial institution for your first deposit. You'll also need to bring a government issued ID such as a driver's license or passport. Your biggest responsibility with a savings account is to keep your account number and information in a safe place. You also need to review your monthly statement and make sure all of the deposits and withdrawals listed on your statement are correct. Insurance companies believe that people who are responsible with their finances tend to be more responsible with managing their risks.



Types of Accounts

Product	Interest Rate	Term
Regular Savings	Good	Withdrawals can be made anytime
Money Market Account	Better	Withdrawals can be made anytime
Certificates of Deposit (CDs) - Regular or IRA	Best	Generally the longer the term, the better the rate

Smart Savings Strategies

- 1 Start the savings habit. Open a savings account if you don't already have one.
- 2 Pay yourself first. Every time you get your paycheck, a raise, or a cash gift, save some of it. Financial experts recommend that you save 10 to 20 percent of your take-home pay every month, but you should pick a dollar amount you can save each month, and stick to it.
- 3 Build an emergency fund. Experts recommend that you save three to six months' living expenses for emergencies. It's also good to have a cushion of extra cash to use for unexpected expenses, such as car repairs or replacing lost or broken items.
- 4 Build your credit history. The first step to building your credit history is to open a savings account and use it responsibly. If you save money on a regular basis, you're proving to a lender that you know the value of money.
- 5 Save automatically. You can do this easily by taking advantage of direct deposit and payroll deduction. With direct deposit, your entire paycheck is put directly into your account. With payroll deduction, you choose an amount of money to be taken regularly from your paycheck to build up your savings account or pay off a loan.
- 6 Don't try to save too much too fast. Be realistic when setting up a savings plan. Keep enough money to enjoy yourself, so you'll stick to your plan.

Calculate Your Return

The Rule of 72:

Compounding means that your money is making more money even while you sleep. One way to see how powerful this can be is called the Rule of 72.

You can figure out how long it will take to double your money simply by dividing 72 by the interest rate. So let's say you get \$200 for your birthday and you want to use it to start saving. If you put the money into an account that earns 6 percent interest a year, how long will it take to grow to \$400?

$$72 \div 6\% \text{ interest} = 12 \text{ years}$$

So in 12 years, your money will have doubled to \$400. But what if you find an account where you could earn 9 percent a year on your money?

$$72 \div 9\% \text{ interest} = 8 \text{ years}$$

Now you will have that \$400 in only eight years. By earning just a little bit more interest, you reduce the time to double your money by four years. And this doesn't include any additional money that you may put into your account over time, which would only speed up the process.

But what if eight years seems too long to wait and you want that \$400 in four years instead? The Rule of 72 can also tell you the interest rate you would need to earn to double your money in a certain amount of time. So for four years it would be:

$$72 \div 4 \text{ years} = 18\% \text{ interest}$$

With only four years to invest, your money will double if you can find an investment that earns 18 percent. Of course, that may be difficult to do as the stock market typically averages only about 10 percent a year over the long term. But you can certainly see how even a small difference in the interest rate you earn can make a big difference in how quickly your money compounds — earning you more money — over time.



The Advantage of Starting Early

There's a huge advantage to starting early. Let's say you start investing \$2,000 every year when you're 18. You put it into an account that grows by 7% each year, and continue to invest the same amount for 10 years. Then you stop and just let that money sit for the next 38 years, where it continues to grow at 7% a year, until you're 65 years old.

Now say your sister decides not to invest until she turns 31. Then she puts \$2,000 a year into an account that also earns 7% a year — and does it for the next 35 years, until she turns 65. Who will have more money?

You will! About \$85,000 more, in fact. After investing only \$20,000, your account will be worth \$361,418. But even though she has invested \$70,000, your sister will have only \$276,474. That's because you had the power of time on your side. **See the chart on the next page.**

If you stick with investing \$2,000 per year from age 18 through age 65, you could end up with more than \$706,000!

Online Financial Calculators:

The web has a wealth of tools and resources you can use to calculate your return. They can also help you answer some common financial questions in the areas of home financing, personal financing, investments, retirement and leasing.

Saving vs. Investing

To many, the terms saving and investing seem the same, but there are some differences that you need to recognize as you work toward achieving your financial goals.

Saving is for the Short-Term:

You'll need to save money for two main reasons:

1. You need an emergency fund. Many financial advisors recommend having at least six months' worth of living expenses readily available for emergencies. You'll want to keep these funds in an account that can be accessed quickly like a savings or money market account.
2. Major purchases within the next few years. Will you be putting a down payment on a home in the next few years? Or perhaps you are thinking about taking a vacation? For major purchases that are coming up, you may want to keep these funds in a savings, money market or short-term certificate of deposit (CD).

Investing is for the Long-Term:

You'll need to invest money for your future needs such as college for your children or a comfortable retirement. Many people invest in stocks, bonds and mutual funds. Some good strategies are:

1. Put time on your side. The longer you invest, the better your chances of getting the type of growth you need to meet your goals.
2. Diversify. Use different types of investments to spread your risk. If one doesn't perform, you still have the others to fall back on.

Save First, Then Invest: It's important to do both. But by saving first, you'll have money available to cover emergencies and purchases so you won't end up raiding your investments.

YOU¹

Age Investing EARLY at 7%

18	\$2,000
19	\$2,000
20	\$2,000
21	\$2,000
22	\$2,000
23	\$2,000
24	\$2,000
25	\$2,000
26	\$2,000
27	\$2,000

No further investing

YOUR SISTER¹

Age Investing LATER at 7%

No investing until age 31

31	\$2,000
32	\$2,000
33	\$2,000
34	\$2,000
35	\$2,000
36	\$2,000
37	\$2,000
38	\$2,000
39	\$2,000
40	\$2,000
41	\$2,000
42	\$2,000
43	\$2,000
45	\$2,000
46	\$2,000
47	\$2,000
48	\$2,000
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51	\$2,000
52	\$2,000
53	\$2,000
54	\$2,000
55	\$2,000
56	\$2,000
57	\$2,000
58	\$2,000
59	\$2,000
60	\$2,000
56	\$2,000
62	\$2,000
63	\$2,000
64	\$2,000
65	\$2,000

TOTAL INVESTMENT: **\$20,000**
YOUR TOTAL AT AGE 65: **\$361,418**

VS

TOTAL INVESTMENT: **\$70,000**
YOUR SISTER'S TOTAL AT AGE 65: **\$276,474**

DIFFERENCE DUE TO STARTING EARLY

\$84,944

¹The investment periods shown reflect 10 complete years for "You" and 35 complete years for "Your Sister." Investments are assumed to be made annually and at the end of the investment period.

The Cost of College

College costs are still on the rise. Here are the latest numbers from the College Board, New York:

The Bad News:

Annual tuition and fees now average about \$6,585 at four-year public universities for in-state students, and about \$25,143 at four-year private colleges. When tuition and fees, room and board, books and supplies, personal expenses, and transportation are added together, average published expenses for one year of college total \$18,326 for a four-year public university, and \$37,390 for a four-year private college. When all the costs for attending college for four years are added up, the average cost of a four-year college education is estimated at \$81,366 for a public university and \$166,009 for a private college (assuming an average 7% annual increase in expenses).

The Good News:

The median annual income of the average full-time worker with a bachelor's degree is a considerable 62% higher than the annual income of a worker with only a high-school diploma. Similarly, those with Master's degrees earn about twice as much. Typical college graduates can expect to earn about 73% more than typical high-school graduates. Likewise, those with advanced degrees can expect to earn two to three times as much.

Clearly one of the best investments you can make for your children is an investment in their educational future!

Saving for a College Education

As with any large savings goal, it's best to start investing early and often for college.

1. **First, set your goal.** Figure out how much you will need to save for each child based on his or her age.
2. **Invest.** Consider investing the majority of your college savings assets in stocks, as these investments have historically provided the greatest long-term growth potential.
3. **Utilize other financing options:**
 - Encourage savings gifts when relatives ask what your children want for birthdays or holidays.
 - Look into Section 529 Plans.
 - Apply for financial aid.
 - Don't rule out less expensive schools.
 - Develop networks and ask questions to find sources of scholarships, grants and loans.

Saving for Retirement

Longer life spans, more active retirements, rising costs and uncertainty over Social Security make the need for a substantial retirement nest-egg greater than ever. Luckily, there are several investment options available to help you save for that anticipated time of life. Some of the most popular choices are Traditional or Roth IRAs, 401(k) plans and 403(b) plans.

1. **Traditional IRAs.** This type of retirement plan offers tax-deferred earnings and the possibility for tax-deductible contributions. You can contribute to a traditional IRA if you earn compensation and will not reach age 70 1/2 by the end of the year. If you file a joint return, you can treat your spouse's compensation as your own. Maximum contributions are determined by your age (under age 50 or age 50 and older) and continue to increase as time passes. All earnings in a Traditional IRA are not taxed until they are withdrawn.
2. **Roth IRAs.** Unlike Traditional IRAs, contributions to a Roth IRA are never tax-deductible. However, the money in your Roth IRA, including earnings, can be withdrawn tax-free. Contribution eligibility is based on modified adjusted gross income. Contributions are allowed at any age and the maximum contribution limit continues to increase.
3. **Traditional 401(k) Plans.** These employer-sponsored retirement plans are open to employees at most companies. Within limits, employees can contribute to the 401(k) plan by having a designated amount of pretax dollars deducted from their paychecks. The employer often matches part of the employee's contribution. Funds in a 401(k) plan are not taxed until withdrawn.

4. **Roth 401(k) Plans.** A Roth 401(k) combines features of the traditional 401(k) with those of a Roth IRA. The Roth 401(k) is offered by employers like a regular 401(k) plan but contributions are made with after-tax dollars. This means that you don't get an upfront tax-deduction but the account grows tax-free and withdrawals taken during retirement aren't subject to income tax, provided you're at least 59 1/2 and you've held the account for five years or more.
5. **Traditional 403(b) Plans.** This type of plan, also known as a tax-sheltered annuity (TSA) plan, is a retirement plan for certain employees of public schools, employees of certain tax-exempt organizations and certain ministers. Individual accounts in a 403(b) plan can be any of the following types:
 - An annuity contract, which is provided through an insurance company,
 - A custodial account, which is invested in mutual funds or
 - A retirement income account set up for church employees.
6. **Roth 403(b) Plans.** A Roth 403(b) is similar to a traditional 403(b) plan but the contributions are made with after-tax dollars - just like a Roth IRA. And just like a Roth IRA, the distributions from a Roth 403(b) are free from federal income taxes.

Generally, retirement income accounts can invest in either annuities or mutual funds. The features of the 403(b) plan are very similar to the 401(k) plan. Employees may make salary deferral contributions that are usually limited by regulatory caps.

Whatever your choice, your retirement plan should be an integral part of your overall financial strategy. Make sure you consider it as you design and implement your personal financial plan.



Retirement Worksheet

1. Total amount of annual income you want in retirement (this figure should be between 70% and 100% of your current annual income)

+\$

2. Subtract the income you expect to receive annually from Social Security (if you make under \$25,000 enter \$8,000; between \$25,000-\$40,000 enter \$12,000; over \$40,000 enter \$14,500)

-\$

3. Total annual income needed (line 1 minus line 2)

=\$

4. To determine the amount you'll need to save multiply the amount, from line 3, by the factor below

AGE YOU EXPECT TO RETIRE:	MALE (up to age 82)	FEMALE (up to age 86)	MALE (up to age 89)	FEMALE (up to age 92)	MALE (up to age 94)	FEMALE (up to age 97)
50	18.79	20.53	21.71	22.79	23.46	24.40
60	16.31	18.32	19.68	20.93	21.71	22.79
65	13.45	15.77	17.35	18.79	19.68	20.93
70	10.15	12.83	14.65	16.31	17.35	18.79

*BASED ON 3% RATE OF RETURN

\$

5. Multiply your current saving to date by your factor below

If you plan to retire in:	Your factor is
10 years	1.3
15 years	1.6
20 years	1.8
25 years	2.1
30 years	2.4
35 years	2.8
40 years	3.3

-\$

6. Additional savings still needed to save for retirement (line 4 minus line 5)

=\$

7. To determine the ANNUAL amount you'll need to save, multiply line 6 by your factor below

10 years	.085
15 years	.052
20 years	.036
25 years	.027
30 years	.020
35 years	.016
40 years	.013

\$

Total amount you'll need to save each year

=\$

Annual percentage rate (APR) - the annual rate of interest without taking into account the compounding of interest within that year.

Annual percentage yield (APY) - the effective annual rate of return taking into account the effect of compounding interest. The annual percentage yield assumes that funds will remain in the investment for a full 365 days.

Compounding - your initial deposit earns interest that is added to your account balance. Interest is then earned on that new balance. Interest may be compounded monthly, quarterly, semi-annually or annually.

Minimum balance requirements - some accounts require that you maintain a minimum balance in your account.

Service fees and penalties - fees for savings accounts are usually pretty minimal, but be sure to read the fine print before you open an account. If your account falls below the minimum balance, you may be charged a service fee.



Savings Basics 101

The majority of the information contained in this book is from NEFE (National Endowment For Financial Education).

However, some of the information is based on the opinions of Capital Credit Union.

