

# Step Down Your Debt

*A concise, unabridged tool designed specifically to help you gain control of your finances, the first step to financial freedom.*

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## **About the Author**

Damian Kennedy, CPA has presided over business development for small, medium and large firms. Mr. Kennedy has over 20 years of experience in Corporate Restructuring, IPOs, Leveraged Buyouts, Mergers & Acquisitions, Taxation and Finance, Financial Planning, Insurance and Investments as well as Executive Operations Management in large companies. Mr. Kennedy has been early pioneer in many financial practices that are common today. For example, he created several of the original equity hedge funds. The scope of the investments included listed domestic equities and junk bonds as well as non-US securities, initial public offerings and private placements.

He has also been instrumental in moving start-up companies to successful businesses. Mr. Kennedy has worked with 40 companies in the past 10 years that are successful companies today, many growing from zero to \$20MM under his leadership. Some of his key skills include: identifying and eliminating waste as well as improving operational and financial efficiency to boost shareholder returns. He has worked with initial and subsequent investors to launch and develop new businesses to help them realize full value.

Mr. Kennedy has worked for Arnold Communications, Bankers Trust, California Energy Company, Deloitte Touche, Goldman Sachs, Grace Geothermal, Hearst Corporation, Jacksonville Electric Authority, Leo Burnett Company, Lincolnshire Capital Management, McDonalds, Northern California Power Agency, Sawyer Miller/IPG, Shell Oil, Sterling Grace Investments, TRW, Value Line. Damian has spent over 20 years in Corporate Restructuring, IPOs, Leveraged Buyouts, Mergers & Acquisitions, Taxation and Finance, Financial Planning, Insurance and Investments as well as Executive Operations Management.

## **Dedication**

*We dedicate this program to our family and friends that encouraged us over the long haul to write it. This kind of encouragement is what you will need as you go through the process of taking control of your finances.*

## **Introduction**

What the program is for and how to use it. The sole purpose of writing this program was to provide concise, effective guidance to you on how to gain control of your money. Because you are reading this book, you believe that you can manage your money more effectively -- you are correct! We can show you how! A basic understanding of some concepts and their implications to you will change the way the look at buying things and services. You will see the value of not making numerous impulse purchases but rather waiting a short period of time to buy the best you CAN afford.

Introducing you to the concepts of saving and spending are the primary purposes of this guide. It is beyond the scope of Step Down Your Debt to explain all of the idiosyncrasies of car loans versus leases, or of 401K loans versus mortgages. We believe, however, that these topics are discussed in sufficient detail so that you will know the proper questions to ask at the bank or your personnel department.

The workbook format was chosen to remind you that this is supposed to be on your table, desk, work surface or wherever you do your reading. You can and should refer to this book continuously during the debt pay down period. Use it to update your records and goals and chart your progress -- it helps! This constant source of ideas should quickly become tattered and torn. This is a very powerful tool -- use it as often as possible and you will succeed!

Most importantly, we have deleted all of the "fluff" to encourage you to read and understand the concepts. Every extra word has been carefully removed to give you all of the information you need to make decisions without being sidetracked or getting bored. Read, understand, and act upon the ideas. You can pay down your debt, become an investor rather than a debtor and get on the road to financial freedom! There is no time to waste, collecting dividends, interest income and rents is more fun than paying interest!

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## **Chapter One**

### *What is your problem and how big is it?*

Everyone who is in financial difficulty must read this book. Several different problems cause a number of financial difficulties. In the simplest case we can view the problems as total debt problems or cash flow problems. An example of total debt problem is a person who simply owes significantly more than he or she owns and might, in the extreme, consider bankruptcy. This means that if you were to sell all the things you own, you would still be unable to pay off your debts. Borrowing money to buy goods and services that have no residual value is the usual cause. Clothing purchases and dining out at restaurants are the most obvious examples. In the absence of making some arrangement with creditors, the only solution to this problem is a reduction in expenditures, or earning additional income.

In the cash flow case, you might be a person who likes to buy fancy cars and expensive homes or apartments and second homes. The car loan or lease payments and mortgages are more than you can afford. However, by changing your lifestyle somewhat you could eliminate the debt. For example, by selling the vacation home, and / or getting a less expensive sports car you could pay off the loans and eliminate your debts. In this case the problem can be solved by a reduction in expenditures, earning additional income or refinancing your debts.

This Chapter will show you how to collect that information and how to evaluate your situation. Chapter Three will suggest some solutions, but in Chapter Four you will use the Debt Eradicator to develop a personalized solution to the problem.

### **Assets**

What do you own? This is a loaded question. Here you make your first choice. Do you really think it is important to figure out exactly what your total assets are? (We will refer to anything you own as an asset throughout the remainder of the book.) Or for simplicity are you going to concern yourself with those assets that you could sell if you so chose in order to reduce your debt load? We recommend the latter. This program is designed to get you out of debt and on the road to financial freedom not a complete course in personal financial planning.

Let's add up your assets. These include everything that is legally yours and can range from the knives and forks in the kitchen drawer to the house you own. We remind you that our recommendation is that you concentrate your efforts on those assets that can be sold since these are the ones that can be used to pay off your debts. They can be classified in several different groups. Those groups include real estate, automobiles, sports and recreational vehicles, stocks, mutual funds and other financial assets, trust funds, Individual Retirement Accounts (IRA's) and other retirement plans, limited partnerships and collections in the broadest sense of the word. Make sure to include all your assets even if you have borrowed money on them.

You may not want to sell any of the items in the lists above. Nevertheless preparing the list itself may give you the feeling of confidence that the money you have spent has not been wasted.

#### Real estate:

In most cases, this will be your primary home, condominium or cooperative apartment and possibly a vacation home. However, for those of you who are real estate investors, be sure to include all of your properties.

#### Automobiles:

Again, in most cases, this will be your car and your spouse's car. However, for those of you who are classic car collectors, be sure to include all of your automobiles.

#### Sports and recreational vehicles:

A boat, snowmobile, jet ski or traditional recreational vehicle (RV) would be included here.

#### Stocks, mutual funds and other financial assets:

We think these are self-explanatory. They include all of the stocks and bonds you hold in your stock brokerage account or are keeping in your safe deposit box. Do not forget to list any stock you own in your company. You may also own mutual funds you have bought over the years. Include gifts of U. S. Government savings bonds or those purchased through your payroll department.

#### Trust funds:

If you are the beneficiary of any trusts you should probably exclude these. The complexities of trust law are beyond the scope of this book. Accordingly, it would be far too difficult for you to use the information regarding the trust in any meaningful way. Complete all of the worksheets in the program. Demonstrate your new-found control of your finances before approaching the trustee to ask him for a loan or other distribution.

#### Individual Retirement Accounts and other retirement plans:

List all of the assets in an IRA separately since they are, by definition, almost exclusively financial assets. Nevertheless the unique ways in which you can access them present unusual problems. Also, there are significant tax penalties for using the money incorrectly. We will explain more about this in Chapter Three. For now, it is not important to break down the assets in your various plans by individual subgroup. That is to say, your 401K money may be invested in the cash fund, a stock fund and a bond fund. For our purposes, they are considered one asset. Simply record the total amount of each account. For example, total IRA balances, total 401K balances and total profit sharing plan amounts. This will greatly simplify the data collection process.

#### Limited partnerships:

These are very popular among the well healed, usually hedge funds and other investment vehicles. However, many people have made investments in private companies. They could be anything from a partial interest in a laundromat to a partial interest in a piece of real estate. Estimate the value at which you might be able to sell this investment.

#### Collections:

This is the broadest category by far. A collection can be a group of just about anything. The most obvious ones that come to mind are model trains, stamps, coins, records and antiques. They could also be old jewelry that you no longer wear or an assortment of tool boxes filled with tools and equipment you no longer use. It could be an assembly of any number of items that could be purchased individually at a garage sale or a flea market. Once again, we remind you that the purpose is to get out of debt. If your collection is best sold at a garage sale, forget it -- it will have no significant impact on your problem. Otherwise, we suggest you have your collections appraised to determine the real value. You may choose not to sell them, but the appraisal may give you a more realistic idea about the cost of your hobby.

### Other Assets:

At this point you should have gathered most of the information you need to calculate your total assets. Use Worksheet One to guide you through the process. You will notice that there is a separate line for "Other assets". Any other items that may be available for sale that are not detailed above should be listed there.

**Worksheet One**  
Schedule of Assets

Category	Asset Description	Current Value
Real Estate:		
Automobiles:		
Sports/R.V.'s:		
Stocks, Bonds, Mutual Funds and Other Financial Assets:		
Trust Fund:		
IRA or Other Retirement Accounts:		
Limited Partnerships:		
Collections:		
Other Assets:		
Total:		

## Liabilities

What do you owe? This is a complicated question. Here you make your next choice. Do you really think it is important to figure out exactly what your total liabilities are? (We will refer to anything you owe as a debt or liability throughout the remainder of the book.) We recommend you concern yourself with those liabilities that you believe are important to pay. If you truly want to get on the road to financial freedom, include the money you borrowed from your cousin to buy the new stereo. He may never ask for the money back, but you should *consider* doing so. Getting out of debt involves a series of choices all of which are important. Ignoring the importance of your previous decisions and your current choices is the reason you are reading this book. Accepting responsibility is a key ingredient to financial freedom!

Now add up your debts. These include everything you own and can range from mortgages to credit cards to personal loans. We remind you that our recommendation is that you concentrate your efforts on the debts that are payable to people who charge interest. Notwithstanding, the money you owe your cousin, he is probably not charging you interest. Paying him off is a noble and desirable goal. Unfortunately for him, using the money to dispose of credit card debts demanding a 19.8% interest rate is far more important right now! Liabilities can be classified in several different groups. Those groups include mortgages and home improvement loans, car loans but not leases (you will see why later), brokers margin loans, loans from trust funds, 401K and retirement plan loans, credit card debt, personal and student loans and loans from pawnbrokers. Include all your liabilities even if you consider them unimportant.

The list may be discouraging, but it is impossible to solve the problem unless you know how big it is.

### Mortgages and Home Improvement Loans:

These are fairly simple. List all of money you have borrowed to buy or improve any of your real estate properties. The list is comprehensive. Include the money you used to buy or renovate a first or second home as well as money borrowed to invest in or repair an investment property.

### Car Loans:

Again, in most cases, this will be car loans to buy your car and your spouse's car. However, for those of you who are classic car collectors, be

sure to include all money borrowed to buy your collection of classic automobiles.

#### Stock broker margin loans:

Any money you have borrowed from your stockbroker to buy stocks, bonds or mutual funds are listed here. These are known as margin loans.

#### Loans from Trust funds:

If you are the beneficiary of any trusts you may have asked the trustee for loans already. If you have, list them on Worksheet Two. If not, we will consider this a possible source of low cost financing.

#### Loans from 401K and other retirement plans:

Frequently, 401K and other retirement plans permit participants to borrow a portion of the assets in the plan. If you have such loans please list them here.

#### Credit cards and other personal loans:

This is, without question, the biggest source of financial distress. You are permitted to purchase anything you want, no strings attached. Unfortunately, since what you are buying normally has no resale value, the credit card company can charge you an outrageous interest rate with "easy" payment terms. The problem is that it is easy to make the minimum payment but nearly impossible to pay off the loan. In Chapter Three you will see why.

#### Income Taxes:

Unfortunately, the Internal Revenue Code has become so complicated that many of us do not file or pay all of our income taxes. List any back taxes you owe to the Federal or your state or city government.

#### Property Taxes:

Although it is highly unlikely that your local government has not foreclosed on your property if you owe past due real estate taxes, list any back taxes you owe here.

#### Student loans:

In order to afford college tuition these days, it is almost imperative that one borrow money to finance the cost of college. List all of your student loans here. Also, you should include any loans you took out to put your children through college.

#### Loans from Pawnbrokers:

For many people, this seems like an unusual source of money. On the other hand, if you have valuable collectibles, pawnbrokers are the most likely source of money. List all of your loans from pawnbrokers.

At this point list all of your credit card and personal debts separately. You will be able to see which ones are the most onerous when you apply the Debt Eradicator to the payments in Chapter Four.

At this point you should have gathered most of the information you need to calculate your total liabilities. Use Worksheet Two to guide you through the process. You will notice that there is a separate line for "Other liabilities". Any other debts that are not specifically listed above should be shown there.

You are able to calculate your net worth by subtracting the amount of money you owe from the amount of assets you own. If this number is less than zero, you have a negative net worth. This is the total debt problem.

If this number is greater than zero, you have a positive net worth. If you are unable to make all of your monthly payments, then you have a cash flow problem. We will discuss this in greater detail in Chapter Four. For now, please finalize your work on Worksheet Two.

**Worksheet Two**  
Schedule of Liabilities

<b>Category</b>	<b>Liability Description</b>	<b>Current Value</b>
Mortgages & Home Improvement Loans:		
Car Loans:		
Stockbroker Margin Loans:		
Trust Fund Loans:		
IRA or Retirement Account Loans:		
Credit Cards and Other Personal Loans:		
Income Taxes:		
Property Taxes:		
Student Loans:		
Loans from Pawnbrokers:		
Totals:		

Congratulations, you have completed the difficult task of gathering all of information regarding your assets and liabilities. Please summarize the totals on Worksheet Three to determine your net worth. Your net worth should *not* be a negative number. If it is, you have just confirmed what you have always suspected -- you spend more than you should. We will suggest ways to correct your spending problem using the Debt Eradicator.

On the other hand, if you have a positive net worth and still cannot seem to make the monthly payments, you have a cash flow problem. We can also show you ways to correct that problem using the Debt Eradicator.

The most difficult part of the data collection part of the program is now over! In Chapter Two, you will use Worksheet Four to collect all of the necessary information regarding your monthly cash income and outgo. We will use this information in conjunction with Worksheets One through Three and the Debt Eradicator to get you on your way to financial freedom.

**Worksheet Three**  
Net Worth

<b>Category</b>	<b>Current Value</b>
Total Assets	
Subtract: Total Liabilities	
Equals: Net Worth	

## **Chapter Two**

### *What are my sources of income and expenses?*

In this Chapter we will discuss many of the various sources of income and expenses. There are literally thousands of ways to earn money and spend it. Accordingly, we have included a schedule of some of the broad categories and certain some specific examples of each. You are, of course, free to establish as few or as many categories as you wish. The only caveat is that the objective here is to get a handle on your finances, not to itemize how much money you spend on sprinkles for your ice cream cones!

This Chapter will show you how to collect information regarding your income and expenses. Be as thorough as possible but please do not go overboard, you have plenty of time to expand the database. Also, keep in mind that some people may refer to their salary as commissions or fees. Please do not get bogged down in terminology, so long as you understand what you mean, you have made an accomplishment! Let's get started.

### **Income**

Where does your money come from? For now we will concentrate on income from working (we'll refer to any money you get from someone else for putting in time on the job as "salary" throughout the remainder of the book) and income from the use of money you already have (we'll refer to any money you get from someone else for investing your money as "investment income" throughout the remainder of the book). There is also the category - Other Income which includes everything else. This could be anything from social security or unemployment insurance to jury duty.

#### Salary:

In most cases, this will be the income you earn from working. Include salaries, bonuses, commissions, fees and consulting income. Farmers, you have a choice, your income can be either salary or investment income. Finally, you have to make the decision whether you want to figure out your income before or after taxes. It is far simpler to use your net pay than your gross pay . To equate the two do the following. If you choose to use the net pay method, show your monthly salary net of all withholdings, then record your tax refunds as other income.

You can do the same thing for medical plan deductions that are reimbursed to you. This will save quite a bit of time and money, since there will be no need to call your accountant to figure your taxes before the year is even over!

### Investment Income:

Again, in most cases, this will be fairly straightforward. Record any income you receive from stocks, bonds, mutual funds and bank deposits. Your accountant will be concerned about whether they are properly called interest or dividends but you will not. If you get it right - great - if you're wrong - so what, it does not change the program.

You may also receive distributions from limited partnerships, other private companies or trusts. Show all of this income here.

Real estate presents an interesting problem similar to salaries. Do you want to go through the trouble of calculating the gross rental income and deducting every expense or do you want to show just the net. In your first try, we suggest the net method, it is very simple and should get very similar results.

### Other Income:

This category includes every kind of income not shown as either salaries or investment income. It can be social security benefits, pensions, IRA distributions, unemployment insurance, welfare, food stamps, jury duty, or royalties from oil and gas wells.

## **Expenses**

This is the group most likely to cause one of two problems. Both of which are detrimental to solving the problem. The first we touched on earlier - getting too involved in the details. Please do not agonize over whether you buy one or two lottery tickets per week. Find a category that includes these amounts and move on! You will have plenty of time to change the amounts when planning your future expenditures using the Debt Eradicator.

The second and more subtle mistake is to omit broad categories of expenses. Some people bring all of their clothes to the dry cleaners. While any one dress, pair of slacks or a suit may be a small amount, the total

spent over the course of a month can be substantial. The same can be true of other "impulse purchases". If you look in your cabinets and there are 200 bars of beauty soap, make sure you estimate toiletries as a category.

Other examples of simple things that go unmeasured are those little parties you throw where you not only provide the food but the wine as well. Suggest to your guests that they stop at the liquor store just down the block!

We could go on indefinitely with examples, but we expect you get the point. Therefore, only one further category. Expenses that do not occur every month. Birthday, Wedding and Holiday presents for example. Auto repairs, insurance premiums, medical expenses, health club dues or vacations are other possibilities. Do not overlook these costs, they could be substantial. While it is almost a certainty that these costs will not be recurring, they will happen and you should be prepared.

Generally speaking we can group expenses into certain categories and you will fill in the details to whatever extent is necessary.

#### Housing:

This category includes all of the major recurring costs of maintaining your house or apartment. These are the mortgage or rent payments, real estate taxes, insurance, water, gas, oil, electricity or other utilities including telephone bills. Maintenance of the property both inside and out and landscaping are important expenses. Remember, do not ignore repairs.

#### Automobiles:

This category includes all of the major recurring costs of maintaining your cars in proper working order. These are the car loan or lease payments, insurance, water, gas, oil, tune ups and oil changes, car washes and repairs.

#### Health Costs:

Include here everything you need to stay alive. Food and groceries, clothing, cleaning, medical costs, toiletries and medical insurance (assuming it does come directly out of your paycheck). Do not include the costs of entertainment here, they are recorded elsewhere.

#### Entertainment:

Include in this category all of those things you do for enjoyment. Parties, vacations, picnics, bowling, sporting events and concerts, going to the movies or renting videos, cable television, books and magazines you enjoy reading, sporting goods supplies, birthday and graduation presents, bridesmaids dresses, computer games and connections to the Internet and so on are examples of this section.

#### Child Care:

Depending upon where and how you live, this may not even be a category. The following items would be included here. Private school tuition, after school activity costs, baseball or soccer dues, baby-sitting, saving for college, special needs expenditures and summer camp expenses are items to be considered.

At this point you should have gathered most of the information you need to calculate your net income. Use Worksheets Four and Five to guide you through the process.

**Worksheet Four**  
Schedule of Monthly Income

<b>Category</b>	<b>Income Description</b>	<b>Monthly Amount</b>
Salary:		
Investment Income:		
Other Income:		
Totals:		

**Worksheet Five**Schedule of Monthly Expenses

<b>Category</b>	<b>Expense Description</b>	<b>Monthly Amount</b>
Housing:		
Automobile:		
Health Costs:		
Entertainment:		
Child Care:		
Other Expenses:		
Total:		

## **Chapter Three**

*How do I reduce my monthly payments?*

### **The Right Lender**

The first big problem we encounter in trying to get out from under a seeming mountain of debt is the question "why are my payments so high?". Payments are determined by three things. The amount you owe, the interest rate you pay the lender and the length of time you will take to pay off the bill. In other words, if you borrow the same amount from two different people and agree to pay it back over the same period of time, the payment to the lender with the higher interest rate will be higher than the other one.

Lenders are a homogenous group. They think alike. If they can get their hands on an asset that they know how to sell, they will lend you money at a lower interest rate. Other things being equal, this will mean a lower monthly payment or a shorter payback period. We are counting on the latter. Lenders like to get their money back faster so that they can lend it to other people who will pay them fees and commissions! If we can reduce your minimum payment you will be able to send the same amount of money and reduce the amount of time it will take to pay off the loan.

So the key to reducing your loan payments is to provide individual lenders with the assets (collateral) they understand in order to make sure they will give you the lowest possible interest rate. Let's start with an obvious example. Have you ever tried to go to the bank and borrow money using your engagement ring or gold watch as collateral? Good luck. Want to have even more fun? Ask a stockbroker the same question. Banks and stockbroker would not lend you money on these kinds of assets under just about any conditions. (We suspect the Rockefeller's may be able to work something out!) On the other hand, a pawnbroker lends money on these kinds of assets all of the time. The lesson - bring the right story to the right lender and you might be able to make a deal. Bring the right asset to the wrong lender and you're wasting your time!

A less unusual case is the one where you own mutual funds that are paying a regular dividend. Something like a US Government bond fund. You use the payments from the fund to pay down your credit card bill. In reality, you are borrowing money from your bank (credit card company) to buy mutual funds. Since the bank (credit card company) doesn't know this,

they are charging you almost 20% interest! At some stockbrokerage firms you can borrow against your mutual funds at about prime rate. This is currently about 8.25%. You can save 11.75% interest by going to the right lender!

How does a lower interest rate help me? You owe \$5,000 on a credit card loan and are paying it off at \$132.47 per month at 20% interest per year. It will take the full 60 months to pay it off. If you reduce the rate to 8%, you can pay it off in 44 months. You can get rid of that burden 16 months sooner! That's one year and four months sooner just by paying a lower interest rate! Now you see how the lenders like to keep you in debt!

So as you can see, getting a lower interest rate is a huge plus in reducing your debt burden! All options should be considered as a way of raising cash inexpensively. Some of the more obvious ones are listed below.

### **Changes in debt structure - get cheaper loans**

#### 401K or other retirement plan loans:

An employer sponsored retirement plan is possibly the best source of low interest rate loans for many people. What makes them particularly appealing is that in many cases you can make contributions to the plan. The employer frequently matches some portion of your contribution. This is "found money". For example, you contribute \$100 to the plan and the employer matches 50% of that. You have an immediate 50% profit on your investment. That's great by any standard!

Your problem is that you do not have the \$100 in the first place. Let me show you why you do! Many of you have a federal tax bracket of about 28%, some much higher when state taxes are included. For purposes of this illustration, the additional state taxes will be ignored. They improve the calculation.

First, ask your employer to withhold \$100 from your paycheck to be contributed to the 401K plan. Your taxes go down by \$28 (\$100 times 28%). In addition, the company puts in \$50 for you. Your total net worth goes up by \$178. This is the \$100 you put in the plan plus the employers \$50 plus Uncle Sam's \$28. Well, you say, that's great, but I have \$72 less in my pocket. The \$100 less the tax savings. This is the money you borrow from the plan.

Many employers now offer loans to employees for up to one half of their account balance. Since you have \$150 (your \$100 plus your employer's \$50) you can borrow up to \$75. As you can see, your net worth has gone way up and you still have the same amount of money to pay your bills.

One caveat, you cannot usually borrow every month, so you will probably only be able to do this once or twice over the course of the program. Please consult your plan administrator and tax advisor prior to taking out any loans from your plan.

Remember, this program is designed to give you the tools to manage your own debt reduction program. Carefully, review all documents with the appropriate advisors prior to taking any actions. All plans are unique, it is beyond the scope of this book to provide specific assistance regarding your individual financial situation.

#### Home Equity Loans or second mortgages:

Although somewhat different in the legal sense, for our purposes we will treat them as one money source. Home equity loans were developed by banks and other mortgage lenders as a way to increase their lending operations. The basic principle is that the lender understands the value of your home and the amount of outstanding debts on it. He will offer you a home equity loan at an interest rate lower than your credit cards because his loan is secured by the equity in your home. The advantage to you is the lower interest rate. The advantage to the lender is that they get to increase their loans. These are a great way to lower your monthly payments.

As always, there is one significant downside. If you do not pay your credit card bills on time your credit may be marred and you will be hounded by collection agencies. It is, however, very rare to be sued or put into bankruptcy by credit card issuers or other unsecured lenders. On the other hand, if you do not pay your home equity loan payments, the lender will foreclose and sell your house. That is a virtual certainty! Do not take out a home equity loan lightly.

#### Credit Card Teaser Rates:

There is intense competition among credit card issuers to attract new customers. You have probably received dozens of pieces of "junk mail" from these companies offering very low introductory finance rates. While we do not suggest that you blindly apply for these cards, a close look might prove helpful. There are two items you should research. How low is the actual

rate? Make sure you understand the jargon. A rate quoted as 5.9% \* does not necessarily mean what it appears to say. The \* is "the fine print". It could mean the prime rate plus 5.9%. Do not be tricked by scanning the promotion quickly. Read it thoroughly before signing the application. Second, how long does the low rate last. It could mean 5.9% for three months then 24% thereafter. Make sure you read the proposal thoroughly before signing the application.

Once you have thoroughly examined the proposal from the credit card company, you may want to take the plunge. The credit card issuer may be offering you a rate of say 6.9% for the next six months on all balances transferred from other credit card issuers. By all means move your balance and take the lower rate. Use the interest savings to pay down the amount you owe. With any luck, another bank will come calling within the next six months and you can transfer the new lower amount to the new company!

#### Employer interest free loans:

Employer interest free loans are a somewhat unusual source of funds. They may be available if you have worked for the firm for a long time or it is a very paternalistic enterprise. The size of the loan will normally be small unless you are an executive. The loan repayments will normally be withheld from your paycheck based upon a mutually agreeable schedule. Consult with a confidant at the company before asking for the money. It is very important to understand that this type of loan is an accommodation to you by your boss. Some bosses view these requests quite negatively. You cannot risk losing your job over getting a loan! Tread lightly here.

### **Sources of additional income or cash flow**

#### Smart buying:

It will come as no surprise to you that being a careful shopper can save a lot of money! There are numerous little "things" you can do to save money and not jeopardize your lifestyle.

The most obvious way to save money is to take advantage of "sales". Every store has "sales" from time to time. With some planning, you can time your purchases to coincide with store sales. While it is a small scale example, the message is important. You go to the supermarket. You need thirty items. You leave with fifty. You just bought twenty items that were not necessary just now. You could have waited until they went on sale and

saved money on each of those items. Doesn't sound like much, but think about it. Twenty items at just 50 cents apiece is \$10.00 per visit. One visit per week is 52 trips. All of a sudden you have saved \$520.00 in one year. We told you it adds up.

The same is true with "no frills" items. Many of these items are identical to name brand products. Remember "generic" drugs. We do not recommend that you make all of your purchases from the generic product section. It has a demoralizing impact on you. Try some of the products and use the ones you like. They will save you money. Use this same attitude at the gas station. Buy regular gas if that is what the manufacturer recommends. At 10 to 20 cents more per gallon for premium grades, the savings add up fast.

The key to taking advantage of this section is to change your attitude. Pay premium prices only for products and services that are truly important. Otherwise, take the lower cost item. Take this example of painting the house. There is certainly no reason to pay the painter double the price to put two coats of paint in the basement! Save money, do one coat and pocket the difference.

#### Reduce "inventory":

Look around the house again. How many toys, clothes, toiletries, tools and food do you have lying around. You used your precious cash to buy these things. Do you need a full year's supply of detergent? Does your husband need twenty six white shirts? All of these things cost money and amount to inventory. You read about it all of the time in the business section. Companies change to "just in time" inventory method. By buying inventory as it is needed companies have saved billions of dollars in interest. You should too! When you are running low on an item, keep your eye out for sales. This way you can still take advantage of sales and keep your inventory low.

#### Refunds - return things you do not need for cash!:

This is far and away the easiest way to increase your cash flow. How many times do you order things from a catalog, or make a point of sale purchase only to realize that you really do not want or need what you bought? How many times do you return it? How many times do you say "it's not worth being bothered"? Look around your house at all of the silly appliances and gadgets you have. Look in your closet at all of the clothes

that just never fit right. How many toys and tools and games broke or never worked right?

How much money did you pay for all of those things. How much will you get at your garage sale? Will you get a penny for every dollar you spent? It is so easy to put the item back in the box with the receipt and leave it by the door. The next time you need something from that store bring it along and return it. The next dress is free! The return paid for it! You just "made" \$20, \$50 maybe even \$100. Best of all it is after tax money. In order to have even \$20 in take home pay you need to make \$30. So think about it, is it really worth returning that \$20 item to put \$30 in your pocket. We bet you agree that it is!

### Coupons:

The notion of using coupons is so quaint these days. They are for the other people! Hold on, we know families that sign up for automatic coupon savings at the local supermarket. No more cutting and clipping. Just get the card and all sale items are discounted automatically. One family we know saved over \$700 in a single year by signing that card. When was the last time someone paid you \$700 for your autograph?

There are many other store like **Toy's R Us**, that use coupons for toys for the kids. They are actually paying you to tear up their paper. That's it! Can you think of an easier way to make money?

### Employer reimbursements - how often we forget!:

How often do you spend money for the company and forget to give them the bill for it? We know how much trouble it is to get receipts and fill in forms. Think about it this way, even if it is a single business lunch every month, you are giving away \$50 or even \$100 or more each month. Why? Surely you have the 3 minutes it takes to attach the receipt to a piece of paper at describe why you are entitled to the money. Assume it takes 3 minutes to collect \$50. That translates into \$1,000 per hour. If you make that kind of money and are reading this book, you really are in trouble!

### Tax deductions - they increase your refund:

Certainly it is beyond the scope of this book to provide you with comprehensive tax advice. Nevertheless, it is important for you to understand that Uncle Sam is your partner in a very big way. With social security and income taxes and state and local taxes to boot, there are many people in combined 50% tax brackets. With that said, it is very important to

have a working relationship with your tax preparer or advisor. Also, try to learn a little bit about taxes on your own from co-workers or friends. Many of your co-workers have learned about unique deductions for people in your business.

Are there special deductions for the clothes you wear? Are you keeping receipts for all of the clothes and things you donated to your local charity? What about the gas and tolls you paid to get to the bake sale to help out? We know you didn't get a receipt from the Salvation Army Santa Claus. Don't drop the money in the dish - mail them a check! Take the deduction. Are you the type that buys all of those Girl Scout cookies from your fellow workers and neighbors kids? At those prices, you might be able to deduct some of the price as a charitable gift.

As we have said before, these may be minor items but remember, even if these costs average only \$10 per week, that's \$520 per year. In a 28% tax bracket, that increases your refund by \$146. Not bad for saving a few slips of paper or writing a few things down in your diary!

#### Simple life style changes:

There are a host of ways you can change your life just a smidgen and save a lot of money. For example, do you meet the girls (guys) for lunch at the kind of restaurant that is conducive to the drinking of alcoholic beverages. If you do, you might want change the destination to health food restaurants or other such places. Besides the negative effects on your physical health, alcohol takes a steep toll on your financial health. Frequently, you can get unlimited refills for coffee, iced tea or even soda. You would need several expensive cocktails (at least) to get a buyback! Again, you'll hear the same mantra, no one lunch will put you in the poorhouse, but even \$5 to \$10 per meal adds up to between \$260 and \$520 per year!

Keep Christmas and other holiday and birthday giving in check. The fastest way to blow a budget is to go overboard here. Even if you cut the amount you spend on each of those ten relatives and friends by \$5 or \$10 each you can make at least one extra payment on your credit card. You know you spend a lot more than that throughout the year. This can add up very quickly into the hundreds and perhaps even thousands of dollars. Trust us, it won't be easy the first time but boy is it worth it!

At this juncture, you might want to review some of the simple low cost savings ideas. Add up the ones that apply to you. We'll bet that if you're reading this book, the savings will easily be hundreds of dollars per year!

Add to that some of your own ideas and soon you'll be paying down those credit cards by the thousands each year!

### Asset Sales:

This requires some careful thinking. What do I own that I do not need and can sell. Use Worksheet One as a guide. You may have listed many of these items there. What can you sell? Anything can be sold at the right price. Be smart about it. If you have a garage sale, please don't price all of the antiques at 25 cents each. Try to add a few cents to each item. Remember, you are hoping to sell in volume. Somebody will buy those \$50 lamps at \$5 each instead of \$2. All of these extra dimes, quarters and dollars add up. Don't attempt to overprice. The idea is to get rid of your "junk" at the highest possible price. Drive a hard bargain, but sell it! You want to use the money to pay off your bills. Always remember that!

Sell the US Government Savings Bonds Aunt Tilly gave you. They are growing at 5% per year and you are paying 20% to keep them. Sell your old stamp and coin collections. Sell your old jewelry. Again be creative. If you haven't used it in years, you aren't going to use it any time soon. All of these things are constant reminders of mistakes you made - Get Rid of Them!

### **Additional Income**

Often we forget how much talent we really have. Now is the time to review your strengths. What particular skill do you have that can turn your hobby or other interests into money? Perhaps your only option is working overtime at the job. If it's available, and you have the time take it.

The biggest complaint we hear about working overtime is that "They take out too much tax.". The MOST IMPORTANT thing to remember, and your accountant will verify this, is how much your total tax bill is on April 15th. If "They take out too much" during the year you will get it back with your refund. Better yet, reduce your regular withholding. But by all means take the work. In almost no case is your tax rate going to be over 50%. So if you get paid time and a half you will be guaranteed to take home - when you file your tax return at least 50% of your overtime pay. That's still 25% more than you usually make! If there are no other costs involved, this is easy money.

Many of you do not have that option. You must come up with some other talent or skill that justifies those extra hours. There are people who are artists, try selling your work. We knew a young man that was running a video store and needed extra money. He was a good typist. He learned desk top publishing. In 1992 he was earning \$35 per hour to type! Not bad money for a few extra hours work.

You can do the same thing. Just be a little creative. You have skills that can make you money. Don't be afraid to try.

### Begging:

This is one of our favorites. It is indeed a humbling experience to beg for something. On the other hand, asking for people to carry their own weight financially is enjoyable. Remember, he who doth not ask doth not get! Don't be afraid to ask Mom and Dad to help you out. They have told you "no" so many times during your life that one more won't hurt much. Of course, at your age, I would make sure you intend to solve your problem before you go to your creators with hat in hand. It just might work this time!

On a much more personal level, are you the kind of person who is always paying for your "friends" drinks and meals? Do you advance the money for the ski house only to find that "they" can't make it for the weekend? Simple changes here pay huge dividends!

Put your "friends" on the spot. Ask them to pay their fair share. Make them pay up front to reserve a space. You will find out very quickly who your friends are and who the freeloaders are. Trust us, the last thing you need are freeloaders carrying badges of friendship. Drop them from your circle. Send them to the local welfare office if they need a handout!

### Downsizing - smaller cars and homes:

We recommend considering this alternative for those who are in very severe financial difficulty. Because these are usually the largest ticket items that people buy, it is important to understand how these purchase affect you financial health. Carefully consider the amount of money you have invested in your car or cars. Do you really need such an expensive vehicle? Can you get by with a Ford instead of a BMW? The savings in money payments even on a leased car can go a long way towards reducing that credit card debt at 20% per year.

Think about your home. Do you **really need** the extra property or extra room? The cost of those additions is not just the price of the house but additional repairs and maintenance, heating and air conditioning, gardening and landscaping and real estate taxes. It is much simpler, of course to reduce the size of your dwelling if you rent than buy but it has to be considered either way.

### Government assistance:

Government assistance comes in all shapes and sizes. It is well beyond the scope of this book to explain all of the various programs provided by the Federal, state and local governments throughout the United States. We will provide you with some specific examples of programs available. That should provide you with the motivation to at least visit your local agencies to start asking questions.

The most far reaching and complex program, by far, is the Social Security program. The rules governing the payment of benefits to eligible workers are mind boggling. On the other hand, the scope of the program is so great that you never know until you ask whether you are entitled to any benefits.

Perhaps most importantly, if you are nearing retirement age, is to get a record of your earnings from your local Social Security office and an estimate of your benefits. You may find, as many people do, that simply working a minor part time job for a year or two will increase their benefits by hundreds of dollars per year for the rest of their lives! No one can pass up this opportunity.

Think of it. Can you imagine making an investment of a couple of hundred dollars in Social Security taxes over one or two years and receiving \$50 per month for the rest of your life! This is the best investment in the entire world! These sort of situations are available to some senior citizens. Contact your local office to see how you may be able to benefit.

For the new parents out there. There are government funded food assistance programs to provide your children with subsidized milk prices. That is no small expense for a young family.

There are government assistance programs for people with disabilities. Free education and training programs if you need to change jobs. There are programs to help single parents raise their children. There are scholarships galore to help pay for higher education for children. There are programs sponsored by utilities, at the government's request to assist seniors with

their utility bills. There are free home energy audits, conducted by utilities, for free, at the government's request to determine the best way to heat or cool your home.

The list goes on forever. Please take the time to ask you friends, family, local politicians and government agencies if you qualify for assistance. Remember, the first words out of the bureaucrat's mouth will probably be "No". The trick to collecting benefits is to overcome their objections, complete all of the myriad of forms and persevere. Once you are in a program the benefits continue for quite some time. The hard part is GETTING IN! It is worth the effort. You can use the money!

#### Annuity IRA payments:

One of the best kept secrets regarding Individual Retirement Accounts is that you **can** take money out before you reach 59 1/2 without a penalty. By agreeing to withdraw a fixed amount of money from your IRA for the rest of your life, you can begin to withdraw money penalty free at any age! Of course, how much you can withdraw every year is dependent upon how much money is in the account and how old you are. Obviously, this will be more beneficial to our more senior readers.

As usual, the rules on IRA annuity distributions are complex, so please consult your tax advisor prior to taking any withdrawals.

#### Utility annualized billing:

Utilities often offer to let you pay your total bill in equal installments during the year. They simply look at your prior billing history, estimate what your total bill will be for the next year and divide by 12. That is your new monthly payment. It will normally stay the same until the last payment when you are either credited with a refund for using less electricity than expected or charged for using more than expected. While this will not reduce your total costs, it will greatly help manage your monthly payments.

#### Life insurance policies:

Many of us have life insurance policies that our parents took out on us when we were very little. Frequently, these policies had a provision to set aside some money every year to increase their cash surrender value. That means that not all of the money you paid in premiums was used to pay the bill. Some of it may be in a "savings account" with the life insurance company. Call your broker. See if you have one. If you do, you may be able to borrow some or all of the cash surrender value.

One of the ways to ascertain if you have such an account is whether you receive an Interest or Dividend Reporting Form 1099 from the insurance company at the beginning of the year. If you do, you almost certainly have such a policy.

## **Chapter Four**

### *The Debt Eradicator*

The Debt Eradicator. This Chapter will show you how to use the information you so painstakingly collected in the first three Chapters to manage your Step Down Your Debt program using the workbook.

You've gone through the first sections and collected all the data about the things you own, everything you owe, the interest rates you're paying, and the interest rates you're earning.

You've calculated and collected the data on how much money you make and how much you spend. Remember, it's not a question of how much detail you have. It's whether you have enough information here to plan your financial future. And that means how can you use your cash flow to get out of debt as quickly as possible?

We said earlier that the order of priority in paying off bills should always be paying off the highest interest rate debt -- regardless of outstanding balance -- before paying off the lower interest rate debts. Simply, that's because the more interest you're paying with every payment, the longer it will take to pay off the loan principal amount.

Of course, you'll be able to modify your additional or excess cash flow to pay off any debts in the priority you prefer and see how the plan is actually going to work. You may want to pay off a doctor bill that is not charging you interest or loans from family members. Those are your modifications. Of course to the extent that you're paying off non-interest bearing or low interest bearing loans, the amount of time that it takes will be a little longer.

Keep in mind that the Debt Eradicator uses your regularly scheduled cash flow or net income to pay off your debts. Net income is the amount of money you earn in excess of your recurring monthly payments [utility bills, phone bills, and the like]. Any additional money is used to pay the credit card balances and car loans that you have. You will fill in the summary amounts from Worksheets One and Two on Worksheet Six Page One.

Assuming you've taken our advice and decided to convert some of your assets into cash to pay off some of your outstanding balances, you'll insert the new balances on Worksheet Six Page One of the Debt Eradicator. That will be accomplished either through a loan, an inheritance or by the

sale of an asset for and that'll reduce the amount of the outstanding balance indebtedness immediately. Then the application of the ongoing cash flow will be used to determine how long it will take to pay off the bills.

To do this, use Page Three of Worksheet Six. Insert the new payment required for each of the bills. Calculate the amount of months it will take to pay off all of your bills. By varying the amounts paid on each bill you be able to figure out how many months it will take to pay off all of your bills under different scenarios.

Finally, bear in mind that the Debt Eradicator portion of the program is a plan. But it's only a plan. It will show you that if you act diligently and do the things we recommend, where you'll be, and when you'll get there.

If you choose not to do the things we recommend, you won't achieve your goals. It's unfortunately that simple. And that difficult.

It's very important to focus on achieving these objectives by coming up with a realistic plan of what you can do. Don't exclude the fact that you may want to take vacation or go to dinner a bit more often. Please don't think that by NOT doing these things you'll accelerate the debt pay down so much that you'll be out of debt in six months.

It doesn't work that way. The idea is to come up with a plan you can live with. And it's achievable because this is the first step toward [a] getting out of debt and [b] becoming an investor and not a debtor.

Good luck.

**Worksheet Six**  
Debt Eradicator  
Table 1

<b>Category</b>	<b>Old Amount</b>	<b>New Amount</b>
Salary:		
Investment Income:		
Other Income:		
Total:		

**Worksheet Six**  
Debt Eradicator  
Table 2

<b>Category</b>	<b>Old Amount</b>	<b>New Amount</b>
Housing:		
Automobile:		
Health Costs:		
Entertainment:		
Child Care:		
Total:		
Net Regular Monthly Cash Flow:		

**Worksheet Six**  
Debt Eradicator  
 Table 3

Category	Old Amount	New Amount
Real Estate:		
Automobiles:		
Sports/RV's:		
Stocks, Bonds, Mutual Funds and Other Financial Assets:		
Trust Fund:		
IRA or Other Retirement Accounts:		
Limited Partnerships:		
Collections:		
Other Assets:		
Total:		
New Amount Less Old Amount:		

**Worksheet Six**  
Debt Eradicator  
 Table 4

Category	Old Amount	New Amount
Use the amount from assets sold to reduce your liabilities		
Mortgages & Home Improvement Loans:		
Car Loans:		
Stockbroker Margin Loans:		
Trust Fund Loans:		
IRA or Retirement Account Loans:		
Credit Cards and Other Personal Loans:		
Income Taxes:		
Property Taxes:		
Student Loans:		
Loans from Pawnbrokers:		

<b>Category</b>	<b>Old Amount</b>	<b>New Amount</b>
Totals:		

**Worksheet Six**  
Debt Eradicator  
 Table 5

Category	Old Payment	New Payment
Mortgages & Home Improvement Loans:		
Car Loans:		
Stockbroker Margin Loans:		
Trust Fund Loans:		
IRA or Retirement Account Loans:		
Credit Cards and Other Personal Loans:		
Income Taxes:		
Property Taxes:		
Student Loans:		
Loans from Pawnbrokers:		
Totals:		

**Worksheet Six**  
Debt Eradicator  
 Table 6

Category	New Amount	Total Amount Owed	Months to Pay Off
Mortgages & Home Improvement Loans:			
Car Loans:			
Stockbroker Margin Loans:			
Trust Fund Loans:			
IRA or Retirement Account Loans:			
Credit Cards and Other Personal Loans:			
Income Taxes:			
Property Taxes:			
Student Loans:			
Loans from Pawnbrokers:			
Totals:			

## Glossary

**Accounts Payable** Amounts of money owed to others. Accounts payable are current liabilities incurred in the normal course of living as you purchase goods and services, with payment due at a later date. If you pay cash for all of your purchases, no accounts payable will appear on your balance sheet.

**Accounts Receivable** Money owed to you by people who have bought goods or services on credit. Accounts receivable is a current asset that continually turns into cash as people pay their bills.--Also called *receivables*.

**Adjustable-rate Loan** (variable-rate loan) The interest rate fluctuates, adjusting periodically to the moves of a key rate, such as the prime rate or one-year Treasury bills.

**Aging** A technique for evaluating the composition of your accounts payable. Aging involves grouping your accounts payable according to the length of time that the accounts have been outstanding.

**Annuitant** The recipient of an annuity.

**Annuity** A stream of equal payments, as to a retiree, that occur at predetermined intervals (i.e., monthly or annually). The payments may continue for a fixed period or for a contingent period, such as the recipient's lifetime. Although annuities are most often associated with insurance companies and retirement programs, the payment of interest to a bondholder is also an example of an annuity.

**Annuity Certain** An annuity that provides a fixed number of payments. If the annuitant dies prior to the completion of the contract, payments continue to the annuitant's designated beneficiary.

**Annuity Due** An annuity in which payments are made at the beginning of each period.

**APR** (annual percentage rate) The actual rate consumers pay on a loan, expressed as simple interest. Many, but not necessarily all, up-front fees are factored into APR. The APR can sometimes be misleading, however, because it is based on the often-false assumption that the loan will be held to maturity.

**Appreciation** An increase in value, as of an asset. Often used to distinguish securities that are likely to provide profits because of increases in price as opposed to dividend payments.

**Asset** Something of monetary value that is owned by you. Assets include tangible items such as inventories, equipment, and real estate, as well as intangible items such as property rights or goodwill. The balance sheet is the financial statement listing assets.

**Automatic Reinvestment** The automatic purchase of additional shares of an open-end investment company (mutual fund) with any dividends and capital gains distributions that are made by the firm. Frequently, funds will permit automatic regular purchases of their shares from checking accounts or other resources. This option (in lieu of actually receiving the payments) permits a mutual fund shareholder to increase his or her holdings in the fund. Taxes still must be paid on the amount reinvested even though no funds are received directly.

**Balanced Budget** A budget in which the expenditures incurred during a given period are matched by revenues.

**Balance Sheet** The financial statement of an individual, business or institution that lists the assets, debts, and owners' investment as of a specific date. Assets are listed in the order of how soon they will be converted into cash, and debts in the order of how soon they must be paid. The balance sheets you prepare with this workbook list items at their current monetary value.

**Balloon Payment** A final payment on a loan that is significantly larger than the payments preceding it. For example, a bond issuer may redeem 2% of the original issue each year for 20 years and then retire the remaining 60% in the year of maturity.

**Bankruptcy** In the legal sense, the condition of a firm or individual when their debts (i.e., what is owed) exceed its assets (i.e., what is owned) or when the firm or individual is unable to pay their bills. Formal bankruptcy may result in reorganization or it may require liquidation and distribution of the proceeds.

**Basis Point** One one-hundredth of a percent (1/100 of 1%). Basis point is used to measure yield differences among bonds. For example, there is a 30 basis point difference between two bonds if one yields 10.3% and the other yields 10.6%.

**Bond** A long-term promissory note. Bonds vary widely in maturity, security, and type of issuer, although most are sold in \$1,000 denominations (or \$5,000 denominations for municipal bonds).

**Borrowing Power** **1.** An individual's ability to borrow significant amounts of money. This term is often applied to people having valuable assets but few outstanding debts. **2.** The amount of money that may be borrowed in a margin account.

**Bracket Creep** The movement of a taxpayer into higher tax brackets as his or her taxable income increases over time. Bracket creep occurs because of the progressive nature of the federal income tax structure in which extra income is taxed at higher and higher rates. As a result of bracket creep, more and more individuals seek tax-advantaged investments. Bracket creep was reduced significantly by 1986 tax reform that reduced the number of tax brackets.

**Call** **1.** An option that permits the owner (option holder) to purchase a specific asset at a predetermined price until a certain date. For example, an investor may purchase a call option on General Electric stock that confers the right to buy 100 shares at \$25 per share until October 17. Calls are sold for a fee by other investors who incur an obligation. **2.** The forcing of an option writer to sell shares of stock at a price stipulated in the contract. Most calls take place just before the expiration of the options. **3.** An issuer's right to repurchase an issue of bonds at a predetermined price before maturity. The feature is used when interest rates fall, so that the bonds can be repurchased and a new issue with a lower rate sold. A call feature is normal for nearly all long-term bond issues, and it operates to the detriment of bond owners. **4.** Redemption of an issue of bonds before maturity by forcing the bondholders to sell at the call price.

**Capital Gains Tax** The tax applicable to gains and losses from the sale of capital assets. Currently the maximum tax rate on long term capital gains is 28%.

**Cash** Coins and currency on hand and in checking account balances.

**Cash Flows** The amount of net cash generated by an investment or a business during a specific period of time. Cash flow is calculated by adding non-cash charges such as depreciation to net income after taxes.

**Cash Surrender Value** The money paid by an insurance company to a policyholder canceling an annuity or cash-value life insurance policy. Cash value accumulates when premiums and interest on any previous cash value exceed the cost of insurance. Generally, the cash value that a policyholder

receives upon cancellation is not taxable unless it exceeds the sum of the premiums paid.

**Cash-value Life Insurance** A type of life insurance in which part of the premium is used to provide death benefits and the remainder is available to earn interest. Thus, cash-value life insurance is both a protection plan and a savings plan. This insurance entails a significantly higher premium than protection-only insurance and, depending on the issuer and the policy, may pay a relatively small return on savings compared with other investments.

**Certified Check** A check drawn on an individual's account in which the financial institution from which the check is drawn certifies that sufficient funds are available to cover the amount of the check when cashed.

**Certified Financial Planner (CFP)** A professional financial planner who has completed a series of correspondence courses and has passed examinations in subject areas such as insurance, securities, and taxes. The designation is awarded by the Institute of Certified Financial Planners.

**Certified Public Accountant (CPA)** An accountant who has met certain state requirements as to age, education, experience, residence, and accounting knowledge. Accountants must pass an extensive series of examinations before becoming CPAs. In most instances, only CPAs are permitted to render opinions on the fairness of financial statements.

**Chapter 7** A bankruptcy option in which a bankrupt firm is liquidated after the courts have determined that reorganization is not worthwhile. A trustee is charged with liquidating all assets and distributing the proceeds to satisfy claims in order of priority. In Chapter 7 bankruptcies the creditors often receive a fraction of their claims and the stockholders receive nothing.

**Chapter 11** A bankruptcy option in which a trustee is appointed to reorganize the bankrupt firm. Although security holders are likely to find their existing claims reduced or replaced with different claims, it is expected that the firm will continue operating. Both creditors and owners must vote approval of the plan before the reorganization can be confirmed by court action and become effective. A Chapter 11 bankruptcy frequently allows the debtor to remain in control of the business.

**Charitable Contribution Deduction** An itemized income-tax deduction for donations of assets to Internal Revenue Service-designated organizations. Certain qualifications, such as a contribution limit of 50% of a taxpayer's adjusted gross income, apply. Of particular interest to investors is the ability to donate appreciated property (i.e., securities that have increased in

value since acquisition ) and to deduct the entire market value of the donated assets without obligation to pay taxes on the capital gains. Likewise, it is generally unwise from a tax standpoint to donate assets that have decreased in value since the date of acquisition. Donations of appreciated property may subject the taxpayer to the alternative minimum tax.

**Closed-end Investment Company** An investment company that issues a limited number of shares and does not redeem those that are outstanding. Closed-end investment companies are fairly rare; their shares trade on the exchanges or in the over-the-counter market. Thus, like stock of other publicly traded companies, share prices are determined by the pressures of supply and demand rather than by the value of underlying assets.

**Collateral** Assets pledged as security for a loan. In the event that a borrower defaults on the terms of a loan, the collateral may be sold, with the proceeds used to satisfy any remaining obligations. High quality collateral reduces risk to the lender and results in a lower rate of interest on the loan.

**Collateralize** To pledge an asset as security for a loan. A loan to a broker is collateralized by pledging securities.

**Collectible** An asset of limited supply that is sought for a variety of reasons including, it is hoped, an increase in value. Stamps, antiques, coins, and works of art are among the many things normally classified as collectibles. Collectibles are often regarded by investors as a hedge against inflation; their values tend to appreciate most when general prices are rising. The collectibles market represents a very tricky investment for inexperienced investors.

**Common Stock** A class of capital stock that has no preference to dividends or any distribution of assets. Common stock normally conveys voting rights and is often termed *capital stock* if it is the only class of stock that a firm has outstanding (i.e., the firm has neither preferred stock nor multiple classes of common stock). Common stockholders are the residual owners of a corporation in that they have a claim to what remains after every other party has been paid. The value of their claim depends on the success of the firm.

**Compound Interest** Interest paid on interest from previous periods in addition to principal. Essentially, compounding involves adding interest to principal and any previous interest in order to calculate interest in the next period.

**Consumer Price Index (CPI)** A measure of the relative cost of living compared with a base year. The CPI can be a misleading indicator of inflationary impact on a given person because it is constructed according to the spending patterns of an urban family of four.

**Corporate Bond Fund** An investment company that invests in long-term corporate bonds and passes the income on these securities to its stockholders. Although these funds vary in value with changes in long-term interest rates, they normally provide a current return in excess of money market funds. Corporate bond funds are of interest primarily to investors seeking high current income or to those betting on a substantial fall in long-term interest rates.

**Credit Rating** A grading of a borrower's ability to meet financial obligations in a timely manner. Credit ratings are set by lenders and by independent agents for companies, individuals, and specific debt issues.

**Current Asset** Cash or an asset expected to be converted into cash within one year. In addition to cash, current assets include marketable securities, accounts receivable, inventories, and prepaid expenses. Current assets are typically not very profitable but tend to add liquidity and safety to a firm's operation.

**Current Liability** A debt due within a year. Current liabilities include accounts payable, short-term loans from financial institutions, current maturities of long-term debt, dividends declared but not paid, and expenses incurred but not paid. Current liabilities are generally met using current assets.

**Current Market Value** The value of an individual's profile when the securities are appraised at current market prices.

**Custodian Account** An account controlled by a custodian rather than the owner of the assets. Custodian accounts are often used for minors or other individuals unable or unwilling to handle their own assets.

**Debit Card** A plastic card that may be used for purchasing goods and services or obtaining cash advances in which payment is made from existing funds in a bank account. Since a debit card provides about the same float as a checking account (two to five days), it is a less desirable method of payment than a credit card. These cards are often part of the comprehensive all-in-one accounts offered by many brokers.

**Defined-benefit Pension Plan** A pension plan in which retirement benefits rather than contributions into the plan are specified. Thus, a retired employee who has reached a certain age with a given number of years of service and who has earned certain income is entitled to a specific monthly pension payment.

**Defined-contribution Pension Plan** A pension plan in which an employer's periodic payments into the plan, rather than eventual retirement benefits to employees, are specified. For example, a defined-contribution pension plan may require an employer to contribute 5% of its employees' gross pay into a fund with contributions earmarked for each employee upon retirement.

**Demand Deposit** A checking account balance held at a financial institution. Since demand deposits constitute one of the most important segments of the nation's money supply, the financial community closely monitors their size.

**Fiduciary** A person (e.g., an investment manager or the executor of an estate) or an organization (e.g., a bank) that is entrusted with the property of another party, in whose best interests the fiduciary is expected to act when holding, investing, or otherwise utilizing that party's property.

**First Mortgage** A real estate loan with the right to payment in full before payments to other lenders are made. First mortgages are generally considered low risk investments although the quality of real estate pledged as collateral is of crucial importance in determining the riskiness of the mortgage.

**General Creditor** A lender with an uncollateralized loan, such as the owner of a debenture. In the event that a borrower goes bankrupt, its general creditors are likely to recover a smaller proportion of what is owed them than secured creditors will.

**Insolvent** Unable to meet debts or discharge liabilities.

**Installment** A partial payment on a financial obligation. For example, an annual or monthly payment to the seller of a farm (or any other asset) on a long-term contract is an installment. Installments are composed partly of principal and partly of interest. If all the installments are of equal size, each subsequent payment incorporates an increasing amount of principal and a decreasing amount of interest.

**Interest** **1.** Payment for the use of borrowed money. **2.** An investor's equity in a business.

**Investment** **1.** Property acquired for the purpose of producing income for its owner. Just as plants and equipment are investments for manufacturers, stocks and bonds are investments for individuals. **2.** Expenditures for income-producing assets.

**Keogh Plan** A federally approved retirement program that permits self-employed people to set aside for savings up to \$30,000 (or up to 25% of their income). All contributions and income earned by the account are tax deferred until withdrawals are made during retirement. Investment opportunities include certificates of deposit, mutual funds, and self directed brokerage accounts.

**Liability** An obligation to pay an amount in money, goods, or services to another party. The balance sheet lists the liabilities.

**Life Annuity** A stream of payments intended to continue during the annuitant's lifetime and to cease automatically at the annuitant's death.

**Line of Credit** A credit arrangement in which a financial institution agrees to lend money to a customer up to a specified limit. A line of credit, generally arranged before the funds are actually required, provided flexibility for the customer in that it ensures the ability to meet short-term cash needs as they arise.

**Net Worth** Total assets minus total liabilities. For an individual, total assets are recorded at current market value.

**Overdraft** A draft for more than the balance in the account on which the draft is drawn. A bank may honor an overdraft, depending on the importance of the customer and on prior arrangements (if any) to cover overdrafts.

**Power of Attorney** A legal document in which a person gives another the power to act for him or her. The authority may be general or it may be restricted to activities such as the handling of security transactions.

**Prime Rate** A short-term interest rate quoted by a commercial bank as an indication of the rate being charged on loans to its best commercial customers. Even though banks frequently charge more and sometimes less than the quoted prime rate, it is a benchmark against which other rates are measured and often keyed.

**Profit-sharing Plan** A savings plan offered by many firms to their employees in which a part of the firm's profits is funneled into a tax-deferred employee retirement account. These plans give employees additional incentive to be productive.

**Savings Bond** A non-marketable security issued by the U.S. Treasury in relatively small denominations for individual investors. Two categories of bonds are available. Interest on them is exempt from state and local (but not federal) taxation.

**Secured Creditor** A creditor with a claim that is protected by specific assets. For example, the owner of a mortgage bond can force the sale of or can take possession of a particular asset if the borrower fails to meet the terms of the lending agreement.

**Secured Liability** A debt for which specific assets have been pledged to guarantee repayment.

**Solvent** Being able to meet debts or discharge liabilities.

**Tangible Asset** An asset such as a building or piece of equipment that has physical properties.

**Term Insurance** Life insurance in which the insurance company pays a specified sum if the insured dies during the coverage period. Term insurance includes no savings, cash values, borrowing power, or benefits at retirement. On the basis of cost, it is the very least expensive insurance available, although policy prices can vary significantly among firms.

**Trust** A legal arrangement whereby control over property is transferred to a person or organization (the trustee) for the benefit of someone else (the beneficiary). Trusts are created for a variety of reasons, including tax savings and improved asset management.

**Universal Life Insurance** A combination of term insurance and a tax-deferred savings plan paying a variable return.

**Unlimited Liability** The liability of the owner of a business for all the obligations of the business. An owner's personal assets can be seized if the business's assets are insufficient to satisfy claims against it. The placement of personal assets at risk is a great disadvantage of proprietorships and general partnerships. The ability to limit the amount of liability to which an

owner is subject is a major reason for the formation of corporations and limited partnerships.

**Withholding** **1.** The holding back of a portion of wages, dividends, interest, pension payments, or various other sources of income for payment of taxes to the U.S. Treasury. **2.** The illegal holding back of a portion of securities allocated as part of a new issue to a member of an underwriting syndicate. The underwriter may wish to keep the securities or resell them to a designated party so as to profit from an expected price rise soon after the issue has been offered to the public.

**Zero-coupon Bond** A bond that provides no periodic interest payments to its owner. A zero-coupon bond is issued at a fraction of its par value (perhaps at \$3 to \$5 for each \$100 of face value for a long-term bond) and increases gradually in value as it approaches maturity. Thus, an investor's income from a zero-coupon bond comes solely from appreciation in value. Zero-coupon bonds are subject to very large price fluctuations. The tax consequences of taxable issues often make zero-coupon bonds more suitable for tax deferred accounts such as IRAs than for regular investments.