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S1 00:00 Hello Kaplan Family. Happy Friday. Jerry Taylor here with another Friday Focus message for you. This is a continuation, as I promised, of last week's Friday Focus show. Something I've been using, actually in my classroom's for a while, I've put together this series of four short lectures for my students regarding personal finance, how they should begin to view their money. Last week you heard Part 1. This week I continue with Part 2. I hope you enjoy it. I'd like to get some feedback from each and every one of you if I can. Are you out there? Is anybody listening? If you are, write me at jtaylor2@kaplan.edu - jtaylor2@kaplan.edu. I would love to hear from you. All right? Let's get on with the show.

S1 01:02 I promised you last week a continuation of our focus on personal finance. So let me spend a moment in review. Remember what I want you to do, what I want you to focus on, what I want you to accomplish in the next six months is a scrupulous analysis of how much you spend day by day. Your daily diary wherein you record every penny that goes out of your family. No matter what the source - cash, checks, credit cards, debit cards. However you're going to spend today, you record it. And you begin to see the patterns of what you really spend money on over time and to begin to develop the budget criteria that you'll use going forward. How much do I spend? How much do I make? I want you to focus on over time how much money you really make. Too many people look at this gross pay notion, say, "I make $37,000 a year," when in fact they make 28, when in fact they make 29, when in fact they make 30 after you deduct for taxes and social security and Medicaid and your health insurance and your 401K or whatever deductions you have. So you need to know how much you spend and how much you make.

S1 02:22 The last point we went over previously, was finally to find out how much you have. That's that personal balance sheet where you're adding up all the things you have, all your assets, the value of all your assets and subtracting the value of all your debts and the difference between the two is your net worth. How much you have. Your net worth. Many of us at your ages, you're going to find you have negative net worth and that's not to panic you, that's simply to inform you of the direction you need to go in and to establish objectives that you will pursue. Establish the how much I have objectives. I have negative net worth now. I want to end that within two, three years. Whatever the number. You pick a number and head there. How much I spend? How much I make? How much I have? Now once you have a real good handle on how much you spend and how much you make, you might find yourself with a little gap there eventually once you get things under control where you're not living paycheck to paycheck. That leads us to today's topic. Credit.

S1 03:36 Your ability to manage credit stems directly from that how much do I make and how much do I spend - that cash flow. Do I have anything extra? Could I make a payment? So before you begin to think anything about credit, you need to get those fundamentals down then understand how much you make and how much you spend and how much you have so you know what you can afford. Because at the end of the day, credit's about affording. You've got to make those payments. Healthy credit, a strong credit score is a vital thing to an effective financial life down the road. You've got to make choices that you can live with. Cash flow. Can I afford it? So that's the first criteria but that's not where I'm really headed today. I just want to talk about what I've discovered to be a fundamental rule, a fundamental, excellent way to approach credit. But I'm not going to ignore "Can I afford it?" That's the first rule. Do I have the cash flow? I've compared what I make to what I spend, and I can afford a payment on a car, I can afford a payment on a washer. Let's not go anywhere before we've been there, before you've accomplished the first three levels of analysis - knowing how much you make, how much you spend and how much you have.

S1 05:05

Let's move on to this fundamental rule of credit. Here's what I want to tell you. What do you call people who talk about life? Many pundits - I'll use that word, I like that word pundit - many life pundits, many people who see themselves as experts on how we should life our lives, advise us not to use credit. Tear up those credit cards. Run away from credit. Credit's bad. That's crazy. That's crazy talk. Almost none of us would ever have a house without credit. Most of us would never have a car without credit. Those are big ticket items. Yeah, you've got to use credit there. But the same philosophy can apply to many aspects of your life. It's okay to have a home loan. It's okay to have a car loan as long as you can afford them. As long as what you spend and what you make allow you to make the payments on that home loan and on that car loan. You find many people-- I have met so many people in my life who you'd call house-poor. They've gone and bought a house and not really paid attention to how much of a payment they could afford and then they end up incredibly strapped for cash month after month after month making that house payment. Whereas they might have taken a little more modest starter home and had a much better life. It is shelter after all. It is just shelter. Many people need to attend to the notion of rent. It's not always bad to rent for a good while in your life until you really have the capital formation to afford that commitment to what is generally a much larger expense.

S1 06:58

So it's funny. I rented for a long time. I was a student, married - you know my story - until late and then I moved to New York City and I stayed there for about ten years. So I would tell you that I was almost 40 - certainly 38 or 39 before - I ever bought my first house because I was living in New York up until that point and I rented. They had rent controls there. I couldn't afford-- I was living in an apartment for 400-- no, by the time I left there I think it was about $550. About $550 a month and the apartment right next door to me, which was a mirror image of mine, had turned over many times. It rented for $1600, so I couldn't afford to leave it and it was nice. It was in a great location. So depending on the circumstances of rent, rent's not always bad. But we know at any rate, when we have pundits who say credit is bad, we know that's not true and even they would agree. Home ownership, in the long run, is very good. Having a car is essential in most cases. So what they're talking about is using credit cards for other things.

S1 08:06

That's where my advise comes into play. You know what credit is, right? It's making payments, paying interest. It lasts a while. When you finance something, it lasts a while. When you use credit, the whole notion of credit-- if you're using a credit card the way I do, I us it to make purchases during the course of the month and then at the end of the month, I pay it off. Sometimes that's painful because I bought too much, but that's the rule. I pay it off. Whatever it is, I reach into savings if I have to and pay it off every month. The use of credit is by inference, an extension of that term - that's credit. When I say okay, I'm going to finance this, I'm going to make payments on this for some period of time. I want you to understand that distinction. We're not talking about day-to-day use of a credit card for those bills you pay off at the end of the month. If you got that kind of discipline, that's fine. But that's what you need to ascertain. Do you have that kind of discipline? Where most people get sidetracked, where most people mess up their credit lives then get into the deep trouble is they use their credit card as an expedient, as an efficiency, to buy day-to-day items and then comes the end of the month, they don't have the money to pay for it.

S1 09:28 If that's you, if you find you're using that credit card for day-to-day items and month after month after month after month, you don't have the money to pay for those day-to-day items, then stop. Stop now. That's what the pundit should really say to you. Stop using that credit card now for day-to-day items because you're growing the debt. Every month, you spend more money than you can pay so your credit card balance grows and grows and grows with day-to-day items, things that you consume at the time. And someday you find yourself thousands of dollars in debt and you have nothing to show for it but a couple of tubes of makeup and what I call French fries. Consumable items that disappear almost immediately and you're still paying for them months later, years later, as that credit card you're using to purchase consumables grows and grows and grows in size. I've advised so many people on their personal finance and it happens often I'll bet get connected to someone when they're really trying to resolve a credit situation. I'll review their credit card debt and oftimes what happens is they're initiating a program - they were, it's a little tougher now - but they were initiating programs, and you can still do it, to where they were going to take out a home loan, they had equity. Equity is hard to come by now in a home, but for a while it was there. For many of us, I have lots of equity in my home. So we're going to take out a home equity loan to pay off their burdensome credit cards.

S1 11:22 Home equity loans are 30 years. So you take that money and you spread it out over 30 years, and so you get the payment down. That's how that works. That's why people do it. They reduce their payment by spreading it out in a mortgage over 30 years. And so I would point out to them, when we investigated what was on these credit cards, make them give me reports or get something back from the bank to show me what they had spent this on, that it was just rife with what I call food, folks, and fun. Over several years, these people had spent thousands and thousands and thousands of dollars on food, folks, and fun - on consumables. And I would turn to them and say, "So let me understand this, you're willing to finance French fries for 30 years? You're going to be paying for those french fries there on line six for the next 30 years? You're willing to pay for makeup for 30 years? You're willing to pay for that day at Disney for 30 years? You're willing to pay for those groceries for 30 years?" See what I mean? When you will use credit for food, folks, and fun, even though that might be the nicest prime rib you ever had last Thursday, you don't want to pay for that for 30 years. As it is, credit cards now can last in the 10s and 12s and 15s and 20 years. If you make the minimum payment-- you check that out sometime. See how much you're paying on that minimum payment. I think they even have to tell you on your credit card statement now. It can be years and years and years before you pay off that balance if you keep making that minimum payment for food, for folks, and for fun. That doesn't make a lot of sense, does it? To go on and on and on paying for things like that literally forever.

S1 13:23 So that's where we're headed in this lesson. I'm telling you right now, credit cards are not made to finance food, folks, and fun. Credit cards are not made to finance French fries. You do not to finance French fries. And if you do need to finance French fries, don't buy them. That's where you got to get in this financial self control. When you're using a credit card to purchase and then finance spontaneous things - especially in this litany that I think you know what I mean by food, folks, and fun - you've got to get that under control. Food, folks, and fun must be paid off every 30 days. That's the rule. Food, folks, and fun must be paid off every 30 days. Now, some fun. A student wrote to me about this within the last week or two because I posted a lecture, comments in class, along this line, and she was like, "Oh, professor, I went to Disney with my family. I had put it on the credit card, and that's food, folks, and fun." But she in her letter had a very specific payment. She was going to pay it off in - now, I don't remember - three months or six months, and she had spent a lot of money. I said, "Relax. Okay. If you can live with your plan on that major vacation to have that thing paid off within six months - I would even say possibly within a year if it was really a big deal." You've taken all your kids to Disney for a week or whatever, a few days, and got a hotel or something in there but-- so I'm not talking about every single vacation but I would still put vacations in there.

S1 15:06

I would still say vacations have to be paid off within the year they were taken. I don't want to see a finance in the vacation unless it's like the vacation of a lifetime. You've been waiting centuries to take this pan-European trip and in the end here's no way. You're going to have to use some credit to do it. Okay, but boy you're stretching the rules on me. I want to see food, folks and fun and generally paid off within 30 days, within the billing period however long that is. There's the odd food, folk, and fun, like a vacation, that you might want to stretch out six months. At the most a year. You follow me on that? You've got to think of what it is you're financing. You just can't stick that credit card out there. Just stick that credit card out there and put stuff on it and then when I hit my limit I'll have to stop. You have to think about what you're putting on it. Credit has a place. Credit has a function. Credit has value. It has value to you. "So what should I use it for Professor? What are you talking about? Okay. I understand. Maybe there is a distinction here that I've not been drawing and maybe I've got to think about this a little more. Food, folks and fun, French fries - I do use my credit card for that." You've got to stop.

S1 16:35

What do we use credit for? How does credit become productive? How does credit become effective? How does credit become useful? It's kind of like that house and that car. You look at the longevity - I guess is good a word as any. The life cycle, the useful life. How long it'll last of the thing you're buying. Credit is a long-term event. Right? Credit's a long-term event - one year, two year, three year, four year, five years, six year, longer. So you should use credit to finance those things whose life expectancy either equals or exceeds the credit function, the credit facility, the credit terms. So what do I mean by that? Well what do you mean? I mean a washer and drier. If you've taken good care of your credit, there's a good use for it. Your washer broke. You know how much it cost to go to the laundromat all the time? If you've maintained healthy credit, then I would condone you looking at a washer and drier saying, okay. I don't know about you but my last washer and drier lasted - I can't tell you how many years - a long time. A long time. Ten years for sure, I think longer than that. So that's okay. We got new ones. They're not so new anymore.

S1 18:06

I don't even know how long the new ones have been in there now, several years, a couple, three, four, and so the credit on them. We used credit to buy them. They had some sort of a - now I don't recall - two years or something like that with no interest.

Certainly I'm going to take advantage of that as long as I can afford it, as long as I know how much I spend and how much I make so I know the gant that says I can make the payments on that washer and dryer, why not take advantage of their zero interest offering? And even if it wasn't a zero interest offering, if I needed to finance it, then I can take advantage of that credit because the term of the loan does not exceed the life of the product. It's a good match. It's a good match. I'm going to sit out there for two years, three years, making payments on it, or a year or whatever, on that washer. I'm focused on it. What portion on your bill is that washer? Say I want to pay it off in a year, I take the price, divide it by a year, and make sure I'm sending that amount to the credit card company every month to pay off that washer. Or two years, or three years. Same thing would apply for other - what do we call them - other big ticket items. Flat screen TV. Your TV broke, you need a new TV, or just it's time for a new TV, the new technology. Now I'm not saying put a TV in every room. Don't go crazy. I'm saying if it's time for your family to get a new television, that's something you can look to finance. That's something you can use credit for.

S1 19:40

We just had a TV break this week. And what's interesting about it, it didn't break. I didn't throw it out yet because it didn't break completely. It has multiple inputs. So back there where the cable goes in, something's wrong there. The picture looks haywire. But back there where the DVD player and the games plug in, the picture is perfect. It's a big old TV but we're trying to figure out what to do. It seems like a shame to throw this thing out that works perfectly through the separate inputs in the back versus just the one where the picture's funky. You know how long we've had that TV? Longer than I've been married and I've been married like 21 years. My not yet wife and I were sitting in my apartment in Port Chester, New York when my old TV broke, and together we went out and bought a new TV. That's the TV that just broke. And it didn't really break all the way. Other inputs work fantastic. It wasn't all that expensive. At that time it was pretty expensive, I guess, but not all that expensive. So it's got what? 23 years? 23 years! You can finance that for a few years. You can feel okay about paying some interest if that's what you need to do.

S1 21:02

If you don't need to, if you can pay cash, pay cash, but not up to a point. Let me talk about cash for a moment. I was doing that a few years ago. I was paying cash for cars for a couple of times. I'm not showing off, I'm not young. I'm not. I amassed a little bit of money out there and I wasn't buying ridiculously expensive cars. I don't even remember what they were, I just know I paid cash for a couple cars. I kind of said to myself, "I'll make the payments to myself. I'll make the payments to myself," so that justified it. Why I should give money to the bank, interest to the bank? You know what happened, and I quit paying cash for cars? So I take $20,000 out of the bank or more to pay cash for a car. I never paid myself back. That habit of, "Okay the payment is $500 a month or $300, so I'll just take 300 and put in that same account," you know that lasts no time at all. You just forget about it and you don't do it. So then five years have gone by when you would have made your payment, or four years, or three years, whatever, and the money is still gone, when you could have borrowed the money and paid it off on that time. And three, four years later, it's paid off. The original money's still in the bank, been drawing interest. I know that the interest expense of the car could exceed today by far the interest you make on the money you invest. But it's not the interest, it's the capital. And suddenly that four years later, there's still $20,000 gone from my savings account when the time I could have paid payments on the car. So if I have made to finance it, and the interest rates are so low now, the financing of the car-- I've had two or three cars in the last-- two or three cars recently. Two I know, that has zero interest.

S1 22:57

Zero interest, one for, I think the car before that was 39 months of zero interest financing. The car I currently have financed, it's nearly paid off. It's a 2009, so I'm sure it's very near the end. I think the interest rate is like 2.25%. That's still more than I'm getting on money, right? But not more than I'm getting on stock market money. My point is sometimes that cash stuff, if you're looking at cash and not credit, you can say, "Let me spend the cash, I'll pay it myself," and you don't. Then the time goes by and you're simply, "Got the car, it's getting old now and I don't have 20 grand, 30 grand, whatever, in the bank." I digress. My point to you is this - simply this - credit can be a useful functional tool when you let the terms of the loan equal - and most of the time, they will come nowhere near equal, they'll be well under - the life of the product. You've got the product there - the washer, the dryer, the color TV, the refrigerator, the dishwasher, the whatever, the lawnmower, some power tools - things that you need to make your life function. If the life of the product matches or exceeds the terms of the loan, and you can afford it, credit is good. Especially on those things that make-- the washer, dryer example is perfect. That's something where if you don't have the washer-- you've got to wash clothes, right? So if you don't have it, you're going to the laundromat - that's expensive.

S1 24:31

You have to do that kind of economic analysis of those cash flows. You follow me there? That's my lesson today. Credit starts off with cash flow. Can I afford it? To do it effectively, you use all your energy to avoid, to halt, the financing of food, folks, and fun. The mission there is to match the terms of the loan to the life of the product. If you will view credit, and if you will view your credit card as a credit instrument - not simply an expedient - if you can't do it, throw that thing away. And open up a new account every time you need to to finance a long term item. If you get overwhelmed by this availability of credit, chuck it away. Get it away from you. Credit is credit. It should be used for those things whose life expectancy exceeds the terms of the loan. And when you use it that way-- one student said "Oh man, you're saying to me, I can go out and fill my house up with appliances and color TVs." No, go back to rule one - know how much you spend, know how much you make. If that gap is not there to afford those things, no, I'm not saying that. I'm not saying just because the life expectancy of the item you want to purchase exceeds the terms of the loan, that means it's okay to go do it. I'm saying that should be the criteria. Once you've established the first criteria, you can afford the payments. All right, so this is-- look, I know this may not-- this may sound too logical, but I can't tell you how many students have said, "I've never thought of it that way before." Using credit the way credit was designed. To use it, apply it to those things whose life expectancy exceeds the term of the loan. That's really the bottom line. All that other talk comes out of one thing. Credit is used effectively when it is used to purchase things whose life expectancy exceeds the terms of the loan. That's all I've got to say about that. And do not put French fries on your home mortgage. Okay now remember, next week we'll follow this up with Part 3 of your personal finance. Hope you enjoy it. Hope you benefit from it. See you then. Bye, bye.