

Getting started on saving

Building wealth is like building a brick wall. You place one brick on top of another and make sure the wall is solid before you put on the next brick. Saving to build wealth is similar—you have to set realistic goals and work to accomplish each step before moving on to the next brick, then the next row.

You may think it is hard to save. But if you set aside even small amounts on a regular basis, in just a short time you can build a cushion to help you weather short-term emergencies, such as car repairs or the need for a new household appliance.

Take your time

You can't build wealth overnight. A good first goal is a savings account for emergencies. An emergency savings account is money you set aside to cover expenses in case you lose your job or suffer an injury that keeps you out of work. Emergency savings can also be used for unexpected and costly household expenses, such as car repairs or a furnace replacement.

Emergency funds should equal three to six months of take-home pay for the family's primary breadwinner.

Interest

Interest is the cost of using someone else's money. Your bank pays you interest when you leave your money on deposit. If you borrow money, you pay interest to the lender. Savings institutions often use the letters APY (annual percentage yield) after an interest rate. This is the amount your money would earn if left on deposit for one year. There are two kinds of interest: simple and compound. Simple interest pays interest only on your deposits. Compound interest is better, because it allows you to earn interest not only on your deposits, but also on the interest you earn over time.

Small changes, big savings

Tracking day-to-day spending can help you to avoid wasting money and to develop a budget. A budget is a spending plan that helps you forecast and control your

expenses. Knowing what you spend now is the first step in creating a budget.

Many people find that a few small changes can add up to big savings. To create a budget, you need to compare your monthly spending to your monthly take-home pay. Once you have established a budget and lived with it for a few weeks, you'll see what to cut back on. If you spend less than you earn, you'll have some money to save.

Scoring a goal

Financial goals are personal markers that you set for yourself throughout life. They often fall into short-term and long-term categories. Knowing your goals can help you save for them. Short-term goals are ones you would like to achieve in one or two years, such as finishing your education or buying a car. Long-term goals may take more time to reach—it might take five years or more to be in the position to buy a home, and much longer to save enough for a secure retirement or pay for your children's college education.

Stashing the cash

It's best to keep your emergency money in an account where you can withdraw it quickly and easily when you need it. (If you are on public assistance, there may be limits to how much you are allowed to have in your savings. Before you start a savings program, check with your benefits counselor.)

Money that is easily available is said to be "liquid." You can keep funds that you might need at short notice in a savings account or credit union share account, a money market deposit account or even a short-term certificate of deposit (CD).

In a government-insured savings account, your money won't earn much interest, but it will be safe and easy to access. Short-term certificates of deposit might pay a little more than a savings account does. You can find CD terms as short as one month. The Bankrate.com website can help you compare interest rates at different institutions.

Savings accounts

Savings accounts are designed to keep your money safe and help it grow. Accounts at banks are insured by the federal government for up to \$250,000. The bank pays you interest on the money you have in your account. You can make deposits into your account and withdraw money when you need it.

Like banks, credit unions offer savings accounts (called share accounts) and other financial services. Credit unions are non-profit savings and lending organizations that provide services to members who have a common bond, such as working for the same company, living in the same community or belonging to the same church. Deposits in federal and state-chartered credit unions are insured for up to \$250,000 through the National Credit Union Administration (NCUA).

Individual development accounts (IDAs) are special sponsored savings accounts that help low-income families save money for post-secondary education or job training, to buy a home or to start their own business. Private and public institutions match contributions. Most IDA participants must take classes to help them repair their credit, create a budget and stick to their savings plan. An online directory of IDA programs nationwide is offered at <http://cfed.org/programs/idas>. Click on "IDA Program Directory," to find local IDA programs.

Setting up an account

To open a savings account, most banks require two pieces of ID, one with a picture on it. You typically need a Social Security number, too. The amount required for an initial deposit varies. Some banks require only \$1—others ask for \$50, \$100 or \$500. You may use cash or a check to open an account.

When you open an account, your banking history may be verified with an account screening company such as ChexSystems. If you've ever had a problem with a bank account, such as closing it without enough money to cover all outstanding checks, you may be denied a new account. To understand why you were denied an account, go to www.chexhelp.com to receive a free copy of your personalized banking history, called a consumer report. If

the screening company has incorrect information on file about you, you have the right to have it corrected.

Getting the most from your savings

If you save regularly, the day will come when you can invest in assets that have the potential to increase in value or earn a higher return. Such assets include stocks and bonds, and your home or other real estate. In the U.S., the greatest source of wealth for most households is the value of their homes.

Most experts advise that you try to save 10 percent of your earnings each year. If this is hard to do, start with a smaller percentage. To force yourself to save, schedule automatic payday deposits that go to a savings account or individual retirement account (IRA).

Certificates of deposit, also called time deposit accounts, are a safe way to make your money grow. Most CDs are issued by banks and credit unions, but you can also buy them through brokerages. CDs sold by banks and some brokerage companies are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000 per depositor.

CD rates vary widely, although they are usually higher than rates paid on savings accounts. You leave your money in the CD for a specified period and in return you earn favorable interest rates. In general, the longer you leave your money on deposit, the higher the interest rate you'll earn. The terms vary from one month to five years. If you cash out a CD before it "matures," you'll pay a penalty.

Investing in the U.S. government

Treasury securities are safe and secure investments because they are guaranteed by the U.S. government.

Savings bonds can be purchased in denominations ranging from \$50 to \$10,000. They earn interest for up to 30 years, but after one year from their issue date you can cash them for their current value. Interest varies, but you always get a guaranteed minimum return. Interest income is subject to federal income tax but not state or local income taxes. You can defer paying federal income tax on the interest until you cash in the bonds. Savings bonds are payable only to the person to whom they are registered.

You can buy Series EE or Series I (inflation-adjusted) bonds. For more information, visit the U.S. Treasury's website (www.savingsbonds.gov).

Tax breaks for retirement

Individual retirement accounts are savings accounts designed to help people put away funds for their retirement. For the latest dollar limits on annual IRA contributions, visit the Internal Revenue Service website at www.irs.gov. Type "Publication 590" in the Search box to learn more. Federal regulations require that IRAs be managed by a custodian, such as a bank, credit union, insurance company, mutual fund or brokerage firm.

There are two kinds of IRA: traditional and Roth.

Traditional IRAs give account holders a break on income taxes in the current year. You can deduct contributions to your IRA from your taxable income when you file your tax return. You don't owe income taxes on your contributions or investment earnings until withdrawal, usually after you are 59½. If you withdraw money from your IRA before that time, you must pay a 10 percent penalty on top of any income tax that is due.

Roth IRAs do not provide a tax deduction in the current year, but they allow you to withdraw your contributions and earnings tax-free in retirement.

You may contribute to both a traditional and a Roth IRA, but the same contribution limits apply to your total (combined) deposits. Go to www.irs.gov for current contribution limits.

You may withdraw your contributions to a Roth IRA penalty-free at any time for any reason. You'll pay tax on any investment earnings you withdraw if the account is not at least five years old or you are younger than 59½ and not disabled or using the money for a qualifying reason such as first-time homebuyer expenses, education expenses and certain out-of-pocket medical expenses. For other exceptions and more information on IRAs, visit the IRS website.

Saving at work

Don't miss a chance to save at work. Some employees avoid participating in company retirement plans because

contributions reduce their take-home pay. But you can maximize your retirement savings by taking advantage of your employer's matching funds. Employer-sponsored plans may match your contributions up to a certain limit, so if you invest some of your own pre-tax money, you'll be eligible for your employer's contributions. At tax time, you will owe less money because the portion of your salary that you contributed is not taxable.

You may be required to self-direct (choose) the investments in all or part of your employer-sponsored savings plan. Use the online tools provided by your retirement plan to make sure your account is well diversified, or contact the plan administrator for help choosing appropriate investments for your goals and timeframe. A diversified account contains a variety of investments—not just your employer's stock.

Risks and rewards

Everyone would like to earn the highest possible return on their money. **But as the potential return goes higher, so does the risk that you might lose your money.**

Savings accounts and bank CDs that are insured by the FDIC offer a smaller return than other types of investments because they are safer. In contrast, stocks, bonds and mutual funds are not insured and you could lose your money.

When you are considering an investment, it's important to ask about potential returns, risk and liquidity (how easy it is to get your money when you need it). It is unlikely that you will find a single investment that gives you the best of all three: high return, low risk and ease of access.

It can be risky for individuals to buy stocks. Do not blindly follow anyone's advice about stocks without checking out the information for yourself. There is no guarantee that stock prices will go up or that you will make money.

Many individuals invest in mutual funds to "diversify," or reduce their risk by investing in a variety of stocks. Mutual funds are portfolios of stocks, bonds or other securities in which the public can buy shares. Each investor shares in the fund's gains, losses and expenses. You can lose money in mutual funds, too.

Resources

America Saves (www.americasaves.org) offers free membership and financial planning advice to those who pledge to save a set amount per month towards a savings goal.

Bankrate (www.bankrate.com) provides current rates for CDs and money market accounts.

Choose to Save (www.choosetosave.org) offers advice on saving for college, a home purchase and retirement.

The Corporation for Enterprise Development (www.cfed.org) has an online directory of individual development account (IDA) programs nationwide.

The Credit Union National Association (www.creditunion.coop) can help you locate a credit union to join.

TreasuryDirect (www.treasurydirect.gov) is a federal government site that provides information on savings bonds and Treasury bills.

Consumer Action

www.consumer-action.org

Contact our Hotline:

www.consumer-action.org/hotline/complaint_form

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