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Lesson 1

Introduction to Personal Finance

(“Money Matters: Earning and Spending”)

Objectives: Students will acquire foundational knowledge about personal finance, enabling them to make informed financial decisions. They will comprehend essential concepts related to budgeting, saving, and the management of income and expenses.

In this session, students will learn:

- How to effectively manage their income and expenses
- The power of good saving habits
- The significance of creating and adhering to a budget
- Understanding debt, interest, and creditworthiness (credit score)

Vocabulary: Budget, Savings, Income, Expenses, Debt, Interest, Credit Score

Concepts: Importance of budgeting, understanding income and expenses, importance of an emergency fund, basics of saving for future goals

1. Understanding Income, Expenses, and Savings

Income refers to money received, typically on a regular basis, for work or through investments. This includes wages from jobs, salaries, bonuses, and benefits, as well as profits from business activities and earnings from investments such as dividends, interest, and rental income. As the foundational element of personal finance, income provides the financial means for spending, saving, and investing. Effectively understanding and managing income is crucial for achieving financial stability and meeting financial goals.

Expenses represent the costs incurred on goods and services to maintain a standard of living or operate a business. These costs can be classified as either fixed or variable. Fixed expenses, such as rent or mortgage payments, remain constant each month, while variable expenses, such as food costs and discretionary spending, can fluctuate. Managing expenses effectively is vital for ensuring that spending aligns with available income and maintaining financial health.

Savings refers to the portion of income that is not spent on immediate expenses and is set aside for future use. This can include money kept in cash, bank accounts, or investments. Savings serve several purposes: providing a financial safety net in case of emergencies, accumulating funds for large purchases, and building wealth over time for long-term goals such as retirement.

Effective savings habits are essential for long-term financial security and reaching significant milestones, such as purchasing a home, financing education, or ensuring a comfortable retirement. The key to effective saving is to establish clear, realistic goals, assess the necessary funds, and set a timeline to achieve these objectives. This process demands discipline and consistency, often involving regular deposits into savings accounts or investment funds tailored to

specific financial targets. By understanding the various savings instruments and their potential returns, one can enhance the effectiveness of their saving strategies and, consequently, their wealth over time.

Moreover, disciplined saving is a powerful mechanism that facilitates the accumulation of needed funds while also bolstering creditworthiness. Consistent savings not only contribute to achieving financial goals without the need to rely on high-interest debt but also reflect positively on one's financial stability, which is instrumental in building a strong credit profile. This fiscal prudence goes beyond mere money management; it fosters a broader sense of discipline and strategic planning in life. It teaches young people to prioritize expenditures, eliminate superfluous spending, and anticipate future necessities, whether that be starting a family or preparing for the golden years of retirement. Through this lens, the act of saving transcends its financial connotations, embedding itself as a cornerstone of responsible living.

Clear it up: From Pennies to Property: The Power of Saving

Alex and Jordan, a young couple, are planning to buy their first home within the next five years. They have determined that they need $30,000 for a down payment to comfortably afford a home in their desired area. To reach this goal, they decide to save $500 every month in a high-yield savings account that offers an annual interest rate of 3%, compounded monthly. By diligently setting aside this amount, they are on track to accumulate the necessary funds for their down payment shortly before the five-year deadline.

- Monthly Interest Rate = Annual Interest Rate / 12 = 3% / 12 = 0.25%
- Interest Earned in Month = Previous Total Savings * Monthly

Interest Rate
- Total Savings at the End of Month = Previous Total Savings + Periodical Savings + Interest Earned in Month

Month	Periodical Savings	Interest Rate (Monthly)	Total Savings
1	$500	$0.00	$500.00
2	$500	$500*0.25% = $1.25	$1,001.25
3	$500	$1,001.25*0.25% = $2.50	$1503.75
4	$500	$1503.75*0.25% = $3,76	$2007.51
...	...	...	...
52	$500	$69.32	$28,298.05
53	$500	$70.75	$28,868.80
54	$500	$72.17	$29,440.97
55	$500	$73.60	$30,014.57

2. The Importance of Budgeting

A budget integrates an understanding of income and expenses. A **budget** is a financial plan that outlines expected income and expenses over a specific period of time. By tracking and comparing anticipated income against planned expenses, a budget helps prevent overspending, ensures financial goals are met, and

facilitates the allocation of surplus income into savings. Effective budgeting is essential for anyone looking to maintain financial stability, adapt to financial changes, and achieve specific financial objectives, such as building an emergency fund or saving for future goals. Through careful budget management, individuals gain a clearer insight into their financial situation, enabling smarter and more strategic financial decisions.

Clear it up: Let's consider the example of Lucas, a high school graduate who has just started his first part-time job while attending community college. He earns $1,200 a month and wants to create a budget to manage his finances responsibly.

Here's how Lucas might plan his monthly budget:

- **Income**: $1,500
- **Expenses**: $1,050
    - Transportation (bus pass and occasional rideshares): $200
    - Cell Phone: $50
    - Food (groceries and eating out): $350
    - Entertainment (movies, games): $100
    - Clothing and Miscellaneous: $100
    - Gifts and Donations: $50
    - Remaining for Unexpected Expenses: $200
- **Savings**: $450
    - Emergency Fund: $150
    - Savings for College Tuition and School Supplements: $300

Lucas's budget ensures that he covers all his essential expenses, sets aside money for future tuition payments, and contributes to his emergency fund. The remaining balance allows him flexibility for unexpected costs, maintaining a balanced financial plan. This budgeting approach helps Lucas stay financially stable and

disciplined as he navigates his new responsibilities.

3. Managing Debt and Creditworthiness (Credit Scores)

Debt is an amount of money borrowed by one party from another, often for making large purchases that they could not afford under normal circumstances. A debt arrangement gives the borrowing party permission to borrow money under the condition that it is to be paid back at a later date, typically with interest. **Interest payment** is the cost of borrowing money, typically expressed as a percentage of the principal, which is the original amount loaned. For example, consider a person who takes out a $10,000 loan to purchase a car. The loan agreement specifies an annual interest rate of 5%, to be repaid over a period of 5 years. The interest rate directly impacts the total amount the borrower will pay back. In this case, at a 5% annual rate, the interest adds approximately $2,645 to the total interest payment amount over the five years, making the total amount paid back approximately $12,645. If the interest rate were higher, say 7%, the total repayment would increase to around $13,880, illustrating how a higher interest rate significantly raises the overall cost of the debt. This example highlights the importance of understanding interest rates when taking on debt, as it affects the total financial burden and the feasibility of the loan repayment.

Interest rates are determined by the lender in a loan agreement or by the issuer of a financial instrument, and they can vary widely depending on the type, duration, and risk associated with the financial activity. For individual borrowers, the interest rate on a debt, and consequently the total cost of borrowing, can be

can be significantly influenced by an individual's credit score. A **credit score** is a numerical expression that evaluates the creditworthiness of a person based on their credit history, derived from credit reports provided by credit bureaus. Lenders use this score to assess the likelihood that a borrower will repay their loans on time. A higher credit score often qualifies an individual for lower interest rates because it indicates a lower risk to lenders. Conversely, a lower credit score might result in higher interest rates, increasing the overall cost of borrowing. This means that managing a good credit score can lead not only to more favorable borrowing terms but also to a substantial decrease in the financial burden of any acquired debt.

4. The Importance of Emergency Fund

An **emergency fund** is a reserve of money set aside to cover unexpected financial expenses. This fund is typically used to manage unforeseen costs such as medical emergencies, home repairs, car breakdowns, or job loss. The primary purpose of an emergency fund is to improve financial security by creating a financial buffer that can help avoid debt when significant and unexpected expenses arise.

For most individuals, it's recommended to have an emergency fund that covers three to six months of living expenses. This amount allows you to maintain your standard of living while dealing with unforeseen circumstances, reducing stress and providing time to adjust without immediate financial pressure.

Having this safety net is crucial because it not only protects against unforeseen financial burdens but also helps maintain your financial

stability and prevents the derailment of your long-term financial plans. Building an emergency fund should be a priority in financial planning, allowing you to face unexpected challenges with confidence.