Personal finance essay sample

Finance

To help the Brittens choose the best investment option for their $ 40, 000 savings, we will compare the returns of the various recommended investments options by calculating their after tax yields.

The various investment options and their after tax yields are shown in the following table

The condominium

The mortgage company requires $10000 as the down payment for the condominium. The $10000 down payment will be deposited in an account which is going to earn interest on top. The interest will off-set some of the mortgage costs. The assumption made here is that the mortgage investment option is the most cost effective and hence affordable. Another assumption is that the house is not for sale and thus no tax on the capital appreciation.

Municipal bonds

Are issued by state, city or local government. Interest received from municipal bonds are exempt from federal tax, exempt from state tax if brought by residents of that state and exempt from local tax if bought by resident of the locality where the bond was issued

Generally is a form of tax savings by people who have large tax burdens. Yields are much lower than corporate bonds.

Corporate stock

Stocks represent equity ownership in a company hence one owns a piece of the company. Because of the high returns of stock, they are always high risk.

The dividend received and capital gains are taxable. Assume no capital appreciation of corporate stocks

Saving account

Offered by most commercial banks. There are basically two types of account in the market

Basic savings account-the interest offered in these type of account is usually very low but the customer can be able to withdraw the money if they so wish. The interest from this account is taxable

Money Market account-the interest offered in this type of account is relatively high compared to other savings accounts. The only drawback with this kind of account is that you cannot freely withdraw the money. The money market account interest is not taxable hence presents a tax saving

High growth common stocks

Common stock represents equity ownership in the company investor therefore is part owner of the company. Stocks usually have high returns and therefore are high risk also. The capital gains and dividend, received are taxed.

There are no dividends in this case but the capital gains is 10%

Recommendation

The amount of savings that the Britten's have is $40000. We can deduce from the calculation of the individual after tax yields of each of the available investments that the first option that the Britten's should invest in is the Condominium.

The condominium requires $10000 and has the highest return. From the table above we can see that it has an after tax yield of 10%. This investment option should rank as the first barring any other factors e. g. mortgage rates, duration and flexibility.

The second investment option should theoretically be the High yielding common stocks. This is because it has the second best after tax yield of 5. 76%. However this could change due to the risk profile of the Britten's. If they are willing to take a high risk since stocks are high risk investments then they can invest in this option.

If they are risk averse, then the Municipal Bonds option is the way to go for the Britten's. This investment option has a return of 5% after tax. Another most obvious advantage of this kind of investment is that it is tax free and hence tax savings.

The overall investment advice is that;

Invest in the Condominium as the first option ($10000) and then depending on the risk profile, if risk takers; invest the remaining $30000 in the High Yielding Common Stocks. If risk averse, invest in the tax free Municipal Bonds

Notice here that the savings account is not considered because it has much lower after tax yield.

Part II Page 2

Credit card finance charges are calculated using different methods by the issuer. Therefore, the credit card holder should be able to understand how each method works thus enabling him/her to choose cheaper source of credit.

There are three methods of calculating credit card finance charges

1. Average daily balance
2. Adjusted balance method and
3. Previous balance method

Average daily balance

This method calculates interest based on the outstanding balance at the end of each day. The outstanding balance is tracked each day by adjusting for any purchases and payments made.

The interest can be compounded monthly or daily depending on the terms of the credit card. If the interest is compounded daily the interest is calculated on the daily balance and added to the opening balance the following day (Street Authority: 2008).

Assumption: interest compounded daily

Day opening balance purchases payments closing bal . finance charge

1 600 – – 600 0.
27

2	600. 27	–	–	600. 27	0. 27
3	600. 54	–	–	600. 54	0. 27
4	600. 81	–	–	600. 81	0. 27
5	601. 08	80	–	681. 08	0. 30
6	681. 38	–	–	681. 38	0. 30
7	681. 68	–	–	681. 68	0. 30
8	681. 98	–	–	681. 98	0. 30
9	682. 58	–	–	682. 28	0. 30
10	682. 58	–	(200)	482. 79	0. 21
11	482. 79	–	–	482. 79	0. 21

12	483. 00	–	–	483. 21	0. 21
13	483. 21	–	–	483. 21	0. 21
14	483. 42	–	–	483. 42	0. 21
15	483. 63	100	–	583. 63	0. 26
16	583. 89	–	–	583. 89	0. 26
17	584. 15	–	–	584. 15	0. 26
18	584. 41	–	–	584. 15	0. 26
19	584. 67	–	–	584. 67	0. 26
20	584. 93	–	–	584. 93	0. 26
21	585. 19	–	–	585. 45	0. 26

22	585. 45	–	–	585. 71	0. 26
23	585. 71	–	–	585. 71	0. 26
24	585. 97	–	–	586. 97	0. 26
25	586. 49	–	–	586. 49	0. 26
26	586. 49	–	–	586. 49	0. 26
27	586. 75	–	–	586. 75	0. 26
28	587. 01	–	–	587. 01	0. 26
29	587. 27	–	–	587. 27	0. 26
30	587. 53	50	–	637. 27	0. 28

Total finance charge 8. 10

Interest daily = 16% ÷12 ÷30 = 4. 4 $^{-4}$

Previous balance method

This method calculated the finance charges based on the balance owed at the end of the last billing cycle. This in essence means that it does not consider the current period's payments, purchases and only credits.

The monthly interest = 16% ÷ 12 = 1. 33%

Previous balance = $ 600

Therefore finance charge = 600 x 1. 33%

= $ 8

The draw back of this method is that the issuing company can charge the credit card holder interest on balances already repaid.

Adjusted balance methods

This method of calculating credit card finance charge considers all the transactions that place during the billing cycle. This means that purchases are added, payments subtracted and credits added to the opening balance in order to arrive at the closing balance in which the finance charge is calculated on (Learn Money: 2008).

This method is the most beneficial to credit card holder in terms of lower finance charges.

Previous cycle balance /opening balance (current period)

= 600 Nov. 1

Add: purchase 80 Nov. 5

100 Nov. 15

50 Nov. 30

Less: payments (200) Nov. 5

630

Monthly interest rates = 16% ÷12 = 1. 333%

Finance charge = $ 630 x 1. 333%

= $ 8. 4

Best source of credit

From the above calculations, it is evident that the cheapest source of credit is previous balance method. But this is the case only because Nancy made only one payment while charging more. Otherwise the best method for the credit card holder is the adjusted balance method in that it considers all payment, credits and purchases. Therefore, if Nancy had made more payments, her finance charge would be much lower under adjusted balance method. This method works best if the credit card holds repays more.

The ideal method if the credit card holders wish to increase the outstanding balance is the previous balance method, this is because the current finance charge is calculated on the previous balance which would be lower than current balance.

Part III Page 3

Advice on financial difficulties

It is not unusual that a person can have financial problems, which can result in his inability to repay the obligations. If a person is unable to meet his current and long term obligations, then, he can file for bankruptcy under Chapter 13-Wage Earner Plan or Chapter 7- Straight Bankruptcy.

Chapter 13-Wage Earner Plan

This bankruptcy plan is basically a rearranging of debtors finances, which results in to a prepayment schedule for the debts owed while at the same time shielding the debtor from foreclosure, garnishment and levies. It is not filed by corporations and partnerships.

For a debtor to qualify to file Chapter 13 bankruptcy, he must show means of repaying past debts as well as have incomes more than cost of living. Debtors must also seek advice of credit counselor within six months before filling for bankruptcy. The debtor must also attend money management classes paid by them before being granted the bankruptcy order.

After the order has been issued, it will be reported in the books for up to 10 years. The benefit of this method is that the debtor will gain from financial advice. This type of bankruptcy leads to a repayment plan of the debts owed.

A Chapter 13 bankruptcy allows the debtor to keep the assets while repaying the debts as compared to Chapter 7, which allows liquidation of some assets.

Bankruptcy orders safeguards the estate by form of an automatic stay, which prohibits repossession without orders of bankruptcy courts.

The debtor formulates his repayment plan which if approved by the court, a trustee is appointed (who charges for the services) and takes over the estate for the period of repayment.

Chapter 7-Straight bankruptcy

This form of bankruptcy extinguishes the debts in the end with some assets being disposed off to pay the debts.

Chapter 7 bankruptcy is not possible for debtors who can file under Chapter 13 or have been discharged from a bankruptcy during the last 6-8 years. The debtor must also attend credit management classes and counseling

Bankruptcy allows the debtors to have an automatic stay where the creditors cannot " touch" the estate without the permission of bankruptcy court.

A trustee is also appointed to oversee the management of the assets with the aim of paying off the debts owed. The trustee sells-off non-exempt assets to pay off the creditors. Exempt assets are mostly personal effects, household, pensions, life insurance, unpaid earned wages, public benefits, part equity on residence and motor vehicles.

A creditors meeting is called by the trustee to discuss the bankruptcy. Secured debts creditors can repossess the collateral provided.

All the debts are cleared except debts such as child support, tax debts and student loans or fraudulent debts.

Any receipt from inheritance, insurance, divorce settlements with 180 days of filing for must be declared to the court.

Therefore if a person cannot comfortably meet their current or future obligations they can opt to file for bankruptcy under Chapter 7 or 13 depending on their status (legal) and their financial position.

Reference

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