Learning at Your Fingertips

Budgeting 102

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Overview

Personal financial management is a subject that is not taught in many schools, but is something that nearly everyone has to deal with in their lives later on. Here are some statistics:

Overview

- Some 58% of Americans do not have a retirement plan in place for how they'll manage their finances when they get old.
- While people generally believe they'll need about $300,000 to support themselves in retirement, the average American has only about $25,000 saved at the time of retirement.
- Average household credit card debt among Americans now stands at a distressing $15,204.

Overview

If these facts are alarming to you, and you want to reverse the trend, read on for specific, targeted advice geared towards giving you a better future.

Becoming A Budgeting Pro

1. Stick to your budget and don’t overspend. This is the first rule of budgeting, and pretty much the only one. It sounds fairly obvious, but it's easy to go over budget, even when you have one in place. Be mindful of your spending habits and what your money is going towards.

Becoming A Budgeting Pro

2. Try to reduce your expenses. Larger expenses can be the most unpleasant but most effective ways to stay within a budget. If you take an annual vacation, consider staying home this year. Smaller expenses can also add up.

Becoming A Budgeting Pro

- Try to identify and cut back on any expensive luxuries you enjoy. If you enjoy a weekly massage or have a preference for expensive wine, cut down on the frequency of these treats so you’re spending money on them only once a month or once every second month.

Becoming A Budgeting Pro

- Save money on smaller expenses by switching to generic brands and eating home more often. Try not to go out to eat more than one or two times every week.

Becoming A Budgeting Pro

- See if you can reduce any of your fixed expenses by switching to a less expensive cell phone plan, reducing your television package, or improving your home's energy efficiency.

Becoming A Budgeting Pro

3. Treat yourself periodically, but within reason. Your money has to work for you, not the other way around. You don’t want to feel like a slave to your budget, or to money in general, so it’s important to allow yourself a small treat every month that won’t break your budget.

Becoming A Budgeting Pro

- Don't abuse your own rewards system to the point where it gets counterproductive and ends up affecting your budget. The idea is to treat yourself to smaller, cheaper items like a latte or a new shirt and to avoid splurging on more expensive items like a vacation or a pricey pair of shoes.

Becoming A Budgeting Pro

4. Pay off credit card balances every month. If you use credit cards, you should try to keep them at a zero balance every month to avoid costly fees. If you cannot pay off the current balances, prioritize paying them off within a reasonable time period so that you can get to zero balances.

Becoming A Budgeting Pro

- Try switching to cash payments for most weekly purchases—particularly “extras” like eating out or coffee shop lattes. This can help you control your spending, as people are more aware of the money they’re spending when using cash than when swiping a card.

Becoming A Budgeting Pro

5. **Cut your taxes.** Take better advantage of itemized deductions when you file your taxes every year.

Becoming A Budgeting Pro

- Start keeping your receipts, especially if you're an independent contractor and work from home or remotely. There are many amenities you can expense as part of your contract work when doing your taxes.

Becoming A Budgeting Pro

6. Appeal your home assessment. If you're a homeowner and have sufficient evidence, you might be able to cut your real estate taxes by challenging the value that a home assessor puts on your property.

Becoming A Budgeting Pro

7. Don't count on windfalls. Don't factor in potential (unsure) sources of revenue, such as year-end bonuses, inheritances, or tax refunds. You only want to include guaranteed money in your budget.

Spend Your Money Successfully

1. When you can borrow/rent, don't buy.
How often have you bought a DVD only to have let it collect dust for years, without using it? Books, magazines, DVDs, tools, party supplies, and athletic equipment can all be rented for smaller amounts of money. Renting often saves you the hassle of upkeep, keeps room in your storage, and generally causes you to treat items better.

Spend Your Money Successfully

- Don't just rent blindly. If you use an item for long enough, it may be best to buy. Perform a simple cost analysis to see whether renting or buying is in your best interests.

Spend Your Money Successfully

2. If you have the money, pay a high down payment on your mortgage. For many people, buying a home is the most costly and significant payment they'll ever make in their lives. For this reason, it helps to be in the know how to spend your mortgage money wisely. Your goal in paying off your mortgage should be to minimize interest payments and fees while balancing out the rest of your budget.

Spend Your Money Successfully

- Prepay early up front. The first five to seven years of a mortgage are generally when your interest payments are going to be the highest. If you can, take your tax return and funnel a portion of it back into your mortgage. Paying off early will help increase your equity fast by lowering your interest payments.

Spend Your Money Successfully

- See if you can't make bi-weekly payments instead of monthly payments. Instead of making 12 payments on your mortgage in a year, see if you can't make 26 payments on your mortgage instead. This will allow you to save thousands of dollars, provided there aren't any fees associated with it. Some lenders charge significant fees ($300 to $400) in order to give you the privilege, and even then only apply the payment once a month.

Spend Your Money Successfully

- Talk with your lender about refinancing. If you can refinance your loan down from 6.7% to 5.7%, for example, while still making the same payments, go for it. You could knock off *years* on your mortgage.

Spend Your Money Successfully

3. Understand that owning a credit card may be very important for establishing credit. A credit score of 750 or above may unlock significantly lower interest rates and opportunities for new loans — nothing to sneeze at. Even if you rarely use the credit card, it's important to have one. If you don't trust yourself, just lock it in a drawer.

Spend Your Money Successfully

- Treat your credit card like cash — that's what it is. Some people treat their credit cards like unlimited spending devices, running up balances they know they can't pay off and only making the minimum monthly payment. If you're going to do this, be prepared to spend significant amounts of your money on interest payments and fees.

Spend Your Money Successfully

- Shoot for a low credit utilization. A low credit utilization means that the debt you put on your credit card is proportionally low to your overall limit.

Spend Your Money Successfully

- In plain English, that means that if you have an average monthly balance of $200 on your credit card but your limit is $2,000, the ratio of your debt to your limit is very low, about 1:10. If you have an average monthly balance of $200 on your credit card but your limit is $400, your credit utilization is going to shoot through the roof, about 1:2.

Spend Your Money Successfully

4. Spend what you have, not what you hope to make. You may think of yourself as a high earner, but if your money doesn't back up that statement, you're shooting yourself in the foot acting like you are.

Spend Your Money Successfully

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Build Your Savings

1. Start by putting away as much of your expendable (excess) income as possible. Make savings a priority in your life. Even if your budget is small, tweak your finances so that you save greater than 10% of your total earnings.

Build Your Savings

- Think of it like this: If you manage to save $10,000 per year — which is less than $1,000 per month — in 15 years, you'll have $150,000 plus interest. That's enough money to put a kid through college today, but not tomorrow if that child has just been born. So, start saving and you may have a significant down payment for that child or for a wonderful house.

Build Your Savings

- Start saving young. Even if you're still in school, saving is still important. People who save well treat it more as an ethic than necessity. If you save early, and then invest that savings wisely, a small initial contribution can snowball (compound) into a significant sum. It literally pays to be forward-thinking.

Build Your Savings

2. Start an emergency fund. Saving is all about frittering away expendable income. Having expendable income means not having debt. Not having debt means being prepared for emergencies. Therefore, a rainy-day fund can really help you out when it comes to saving money.

Build Your Savings

- Think about it like this: your car breaks down and you suddenly have $2,000 in extra payments. You didn't plan on this happening, so you have to take out a loan. Credit is tightening up, so your interest rates might be pretty high. Pretty soon, you're paying 6 or 7 percent interest on a loan, which cuts into your ability to save for the next half-year.

Build Your Savings

- If you had an emergency fund, you could have avoided bringing on the debt, and the associated interest rates, in the first place. Being prepared really pays.

Build Your Savings

3. When you've started saving for retirement and put money in your emergency fund, put away three to six months' worth of expenses. Again, saving is all about being prepared for the uncertainty of it all.

Build Your Savings

If you're unexpectedly laid off work, or your company reduces your commission, you don't want to take on debt in order to finance your life. Setting aside three, six, or even nine months' worth of expenses will help ensure that you're in the clear, even if disaster strikes.

Build Your Savings

4. Begin paying off your debt once you're established. Whether it's credit card debt or debt left on your mortgage, having debt can seriously cut into your ability to save.

Build Your Savings

Start with debt that has the highest interest rate. (If it's your mortgage, try paying off larger chunks of it, but focus on non-mortgage payments first.) Then, move onto your second-highest rate loan, and begin paying that off. Move down the line, in decreasing order, until you've paid off your entire debt load.

Build Your Savings

5. Begin really ramping up for retirement. If you're getting to be that age (45 or 50), and you haven't started saving for retirement, it's really important to start ramping up right away. Make your maximum contributions to your IRA ($5,000) and your 401(k) ($16,500) every year; if you're older than 50, you can even make so-called catch-up contributions if you want to pad your retirement savings.

Build Your Savings

- Put a high priority on saving money for retirement — even higher priority than saving for your children's college education. Whereas you can always borrow money to help pay for college, you can't borrow money to help fund retirement.

Build Your Savings

- Consult a financial planner or advisor. If you want to maximize your retirement savings because you have no clue how to start, talk with a licensed professional planner. Planners are trained to invest your money wisely, and usually have a track record of return on investment (ROI).

Summary

You have to treat your money wisely while you are young to secure your financial future. There are lots of ways to save and budget. The key is to start early and plan ahead. It will take some discipline, but with the resources online and in person, you should be able to make the right decisions.