Household Finance 101: Budget, Debt, Savings

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Money: Beliefs, Emotions

- Attitudes about money: how did you grow up and how did your parents handle money?
- Does more money make you a happier person?
- What percentage of lottery winners go broke or go through bankruptcy?
- Are you a spender or a saver?
Americans are Choking on Debt!*

- The average U.S. household debt is $135,065 (includes mortgage debt, credit cards, student loans, other).
- The average U.S. credit card revolving debt is $6,741 (balance not paid off).
  - 189 million card holders average 3 cards; $1.1 trillion.
- Average US car loan debt: $27,630; avg payment $499. $1.16 trillion.
- Average student loan debt: $47,634. $1.5 trillion.

*Source: Nerd Wallet Harris Poll (2018)
Choking on Debt.......Affluenza

• Six of ten millennials could not cover a $1,000 emergency without borrowing money.
• 52% of Americans could not cover the cost of a $1,000 emergency. (CC becomes emergency fund)
• Nearly half of Americans have no retirement savings whatsoever (IRA, Roth, pension, etc.)
• 29% of people aged 55 and older have no retirement savings.
• People aged 55-64 have an average of $80,000 in retirement savings.
Consider $80,000 in savings at age 64

• $80,000 @ 5% = $4,000/year; @ 10% = $8,000/year
• SS income of $12,000 to $20,000/year.
• Question you must ask yourself is: can I make it on that?
• These are the kinds of questions you need to ask yourself.
Debt by Age Group – Federal Reserve Data

Your home is an appreciating asset!

Your car is not an appreciating asset!
Take a Self Examination

• Questions to ask yourself/yourselves:
  • Number 1: Do I have an emergency fund?
  • Number 2: How much debt do I have?
  • Number 3: Do I have 3-6 month’s worth of living expenses? (Job loss)
  • Number 4: Am I saving enough for retirement?
  • OTHERS:
    • What is my net worth?
    • How stable is my job/business?
    • Am I saving for a child’s college or post-secondary education?
    • Am I saving for other wants and needs (car, vacation, etc.)?
    • Am I looking for a greater return on my investments?
    • What do I really know about the stock market, mutual funds, and bonds?
    • What is my age?
    • What is my tolerance for risk?
What’s the Right Order? How Do I Prioritize?

• Emergency Fund
• Debt reduction/elimination (non-mortgage)
• 3-6 month’s worth of living expenses
• Save 15% for retirement
• Children’s college savings
• Pay off your mortgage early
• Save and give
• It’s a process. It takes time.
Financial Freedom......from Debt!

• How would your life look if you had no debt?
• How would you like to know that you have the money in place to take care of an emergency w/o running to the “bank of the credit card”?
• In order to live your dreams, you must get your debt under control, or better yet, eliminated.
• Have you ever heard the phrase, or used it yourself: “I’ll be working up to lunchtime the day of my funeral?”
Debt Reduction Begins With a BUDGET!

• Budget tends to be a negative word.........
• Budget = Discipline
• Budget = Control
  HOWEVER!
• Budget can be a POSITIVE WORD
• It helps you get where you are going!

We’re all a product of the values with which we were raised.

Everyone has different values: what is important to one person is not necessarily important to another.

Suggestion: Find an online budgeting tool or create your own spreadsheet: Example is Every Dollar. Or, create your own spreadsheet.

Most Americans live paycheck to paycheck; learn to live BELOW your means. THIS IS PARAMOUNT!
Issues with Budgeting

• Perspective Problems
  • Your perception – I can’t do a budget!

• People Problems
  • Relationships
  • Couples
  • Spender vs. Saver

• Process Problems
  • Anxiety is experiencing failure that hasn’t occurred yet!

• Perspective Problem:
  • Apathetic
  • Procrastination
  • Denial
  • Must look in the mirror
When Developing a Budget:
The “Four Walls” We Need to Protect:

• Housing/rent/payment
• Utilities
• Food and Clothing
• Transportation
• These items are non-negotiable
The Things We Don’t Need

• Campers
• Boats
• Toys
• Expensive vacations
• In general; things non-essential to survival!
• Here’s the thing: you can have those things when you have the cash to pay for them.
• If swimming in debt now, it’s time to sell non-performing assets.
Then Consider Your Choices - Budget

• Paying down debt, or buying stuff?
• Paying down credit card or taking a vacation?
• Disneyland? Example
• Making an extra annual mortgage payment or buying a remote control toy car?
Budgeting - Tools

- First: track your monthly income and expenses
- Dig out old records if you do not remember. Do you have a filing system?
- Rent, utilities (electric, gas, water, phone, internet, TV, cell), insurance, giving, saving, credit card, student loans.......compile these all. Some months higher than others....... 
- Is there “too much month at the end of the money?”

- Use an Excel spreadsheet
- Software; some that is free
- A notebook and pencil or pen
- “Every Dollar”
Finding Leaks and Slow Drips - Budgets

• Budgets: If you already have one, look at where the “leaks” are.
• Examine your budget; then examine your bank statement, cash spending, etc.
• Finding the leaks; using the leaky money to save for emergencies or pay down on debts.
• A review of “wants” and “needs” curve.
• Put it on a spreadsheet, a Big Chief tablet, or somewhere.
Think about this: What Would You Do IF?

Budget

• Someone gave you $ 500 in cash?
• $ 1,000 in cash?
• $ 5,000 in cash?
• $ 10,000 in cash?
• Write it down. For each. If married; you AND your spouse.

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Self-Directed Homework!

• Put together a list of items for your monthly budget and the amount for each item.

• Recommended amounts:
  • Housing – 25%
  • Food – 10-15%
  • Utilities – 5-10%
  • Insurance – 10-25%
  • Health – 5-10%
  • Transportation – 10%
  • Saving – 10%
  • Giving – 10%
  • Personal spending – 5-10%
  • Miscellaneous – 5-10%
Part I. Create an Emergency Fund

• When the credit card becomes the emergency fund........

• Can the “leak” get converted into an emergency fund?

• It is the first mental “win”

• I CAN save!

• I CAN see the light!

• You’ve got a start on finding your way to financial freedom!

• Do you have an emergency fund?
Saving for a $1,000 Emergency - $2500 is better!

- Tax refund – put it in savings
- Empty the change box
- Sell “stuff” – the trumpet, the guitar, the row boat; my case, a saxophone (not sold yet), pair of boots (not sold yet!), and a drum!
- Have a garage sale! Combine fun with money!
- Reduce the cable bill or cancel it
- Shop auto and homeowner’s insurance

- Baby sit
- Walk someone’s dog, clean a house, mow yards, clean off sidewalks
- Deliver pizza in the evenings
- Work a second job (20 hours @ $11.00/hour = $ take home/week/ $600/month)
- Do what ever it takes.
- A word on setbacks
Setbacks

• Don’t give up......
  • We all have these challenges; you are not alone.

• A root canal and a new crown;

• A transmission in the car goes out

• Auto accident and you have a high deductible

• Emergency money gets depleted quickly.
  • DON’T DESPAIR!
Where Do I Put the $1,000?

• Simply open a savings account at the bank if you do not already have one.

• The money needs to be liquid, so DO NOT invest in the stock market with this fund.

• Maintain discipline to not spend it unless and until an emergency occurs.
Step 2: Get Out of Debt!

• Let’s reiterate what debt does:
  • Imprisons you to a life of payments.
  • A slave is always in debt to it’s master.
  • Robs you of your future..... “I’m going to have to work up to lunch the day of my funeral”.
  • Debt collection agencies are a part of your life if you don’t stay out of debt.
  • Mindset change. It’s like a diet.
  • Is some debt good?
  • A word on credit scores.
Reducing/Eliminating Debt

• Make a list of all debts (non-mortgage first) starting from smallest to largest.

• Credit cards, medical bills, auto loans, department store cards, school loans, etc.

• Let’s forget about the interest rates for now. That is less important when attacking debt.
List of Debts:

- $1500 credit card
- $8250 second card
- $15,000 on car 1
- $35,000 on car 2
- $55,000 on student loan
- $125,000 on mortgage
- TOTAL: $239,750
  - Less the mortgage: $114,750
Side Note: Get Rid of the Credit Card(s)?

• Cut up the cards if you cannot control it. Part of the budget planning process.
• If you are not paying it off in full, every month, you are paying EXTRA for EVERYTHING!
• “But I need my card to build a credit score, or but I get points!”
• The “psychology” of plastic.
• I give you my card, I get it back
• I give you cash, debit, or a check, there is an emotional tie to that.
Lesson: Structure of a loan

- Borrow $25,000 for a car
- 4.5% interest for 60 months
  
  **You paid $2965** in interest over five years.
- Plus you paid $25,000 for the car.
- After five years, the car is now worth $4,000.
- You gave up $21,000 + $2965 or $23,965. For the privilege of driving the car.
- Not including taxes, registration, insurance, tires, and maintenance. This easily amounts to another $1,000/year; maybe more.

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**First six months**

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**Last six months**
Let’s instead........

- Buy a $7,500 used car. It’s not what you really wanted, and you’ll probably have more maintenance costs, BUT:
  - If you can pay cash, or the difference in cash if you’re trading one in........
  - Your taxes and insurance are lower.
  - MOST of the depreciation is out of the vehicle. It might be worth $1,500 at the end of it’s useful life, but you’ve only given up $6,000 plus other costs.
  - You could invest the rest.
  - You saved $17,500. Sock that money away in a mutual fund for five years.
  - $466/month in 12 months = $5,592.
  - Invest in a mutual fund making 9% (easy to do). Next year, you have $6,327.
  - If you do that for 48 months, you’ll have saved $27,269.
  - REMEMBER THE BIG THING: a car, unlike a home, is a depreciating asset!
Question Every Purchase......What Does It Mean for My Net Worth?

- You rent a house or apartment, you pay your bills, you survive.
- You qualify for a $30,000 car loan.
- No retirement savings.
- It is your only material asset besides furniture and clothes.
- You have $1,000 in the bank and owe $30,000 on the vehicle.

- Assets – car worth $25,000 and Personal items/savings = $5,000
- Total $30,000
- Debts:
  - Student loan of $40,000
  - Car debt $30,000

Your net worth is negative $40,000.
Savings vs. Investing

• Savings is translated to mean “safe”
  • Save for emergency fund
  • Save for 3-6 month’s expenses

• Investing is for “risk” capital

• Do not risk your capital for emergencies, job loss.

• WHAT are you investing for?
  • Investing is for building wealth; may be through retirement; if that is set, then other things.
  • Comes later; AFTER getting rid of debt.
You Probably Need to Know Where You Are.....and Where You Are Going!

• Looking for the next “hot stock” or other investment vehicle probably not a good idea if you have a lot of debt.
  • It’s too risky; even with mutual funds! Precious metals; likewise.
  • Get priorities in order first.
  • Look at paying down debt; save for emergencies, living expenses; then look to invest!
  • Calculate your net worth; minus liabilities.
Part III. Save for 3-6 months of household income

• Doing so will give you financial peace of mind.

• It will give you a feeling of accomplishment.

• You know you will be able to handle job loss, if it occurs.

• Three months, or six?

• Considerations.......
3-6 Months......continued

• Is your/are your job(s) relatively secure?
• Do you have large events coming up?
  • Expecting a baby?
  • House repairs?
  • Car repairs?
  • Commissions?
  • Bonuses?
  • Tax refund?
Liquidity of This Account

• There are a lot of investing avenues to look at.
• Passbook savings accounts (<.25%) – easy, quick to get to.
• Short term CDs (1-2%)
• Money market mutual funds (1.5-2.0%)
• All are low risk, low return funds
• More risky? Do I dare?

Liquid Assets

In most cases, investments are not as liquid as savings.

Less Liquid Investments

More Liquid Savings Tools

Savings are known as liquid assets, because they are easily accessible (turned into cash) in emergency situations.

Of your assets, which are the most liquid?
Part IV. Investing for retirement

- Minimum of 10% should be saved; 15% is better.
- 401(k) or 403(b)? Pension? IRA? Roth IRA?
- Employer match?
- What is the investment vehicle? Likely mutual funds.
  - What is a mutual fund?
- Do you have a choice of investments?
- Lifecycle funds; or pick your own mutual funds?
- More risk = More reward
- How close are you to retirement?
- Compounding

The Rule of 72

\[ \text{Doubling Time} = \frac{72}{\text{Interest Rate}} \]

 Behold the Power of Compound Interest
Age considerations – Stages of life

• Young (21-35) – invest very aggressively.
• Mid-career (36-50) – be moderately aggressive.
• Late-Career (51-60) – don’t be afraid of SOME risk; probably get more conservative here; more bond funds.
• Approaching retirement (61-67); PROTECT THE NEST!
The Key: Start Early, Save Often, and Save Regularly for Retirement

• If you learn **NOTHING ELSE** from this presentation, please know that this is **THE SINGLE MOST IMPORTANT** equation to creating wealth for retirement.

• You can never start too early.

• Rule of thumb: plan to replace about 70% of pre-retirement income.

• Google Nerd Wallet
• Retirement Calculator
Scenario: Waiting to Invest for Retirement

• Two people
• 1 is 22, other 30. Both start at ZERO.
• 22 year old out of school, making $35,000 and 30 year old making $42,000.
• Each saves 10% of salary in a 401(k); Roth, other investment vehicle.
• 30 year old waited 8 years before he/she decides they better start saving for retirement.
• At age 67, each will have how much in their retirement account?
• Assumption: 2% annual pay raises; 3% inflation; 6% return on the investment vehicle.
Save Early; Save Regularly

• 22 year old: just shy of $1.0 million.
• 30 year old, $690,000.
• $310,000 difference.
• Life expectancy 85 years. 18 years.
• 5% return during retirement
  • $50,000 per year for 22
  • $34,500 per year for 30
  • Does not include SS income.
Change Retirement Contribution to 15%

- 22 year old will have $1.49 million
- 30 year old will have $1.03 million
- The power of compounding is the eighth wonder of the world.
- Did I say to start EARLY?
  - 22 - $74,500 annual
  - 30 - $51,500 annual
  - Another $20,000/yr in SS?
Part V. Saving for Kids’ College Education

• 529 Savings plans
  • Tax advantages – state only
  • Generally a low rate of return
  • Pretty safe
  • Easy to withdraw

• Uniform Gift to Minors Act (UGM) old.....new is:

• Uniform Transfer to Minors Act
  • In either case, once transferred to the child, custodian loses control

• In Kansas, after age 21
  • Recommend the 529 plan as the most viable.
  • Withdrawals are transferrable to another person
  • Can only be used for educational expenses.
Part VI. Paying Down the Mortgage

- This is the BIG ONE for most folks in terms of debt
- 15 or 30 year mortgages
- Conventional; FHA
- If held for a period of time it is an appreciating asset; probably your largest.
- Interest is deductible IF you itemize.
When Should You Pay Down Your Mortgage?

• Only after all other debts are paid off.
• Exception: if you can budget one extra mortgage payment per year or 26 bi-weekly payments
• What is the rate of return on other investments?
• Many things to consider
Extra Payments

• This step should only be considered AFTER your other debts are satisfied.
  • Remember: other loans are generally NOT appreciating assets!

• Check with your mortgage company if extra payments are allowed (should be).

• Make sure the mortgage company knows that it is to be applied to the principal of the loan.

  • On 30 year mortgage:
    • You’ll pay off 4 years early
    • You’ll pay $ 12,000 less in interest.

  • On 15 year mortgage:
    • You’ll pay off 1.5 years early
    • You’ll pay nearly $ 4,000 less in interest
    • You’ll pay $ 21,000 less on 30 year loan and end seven years early if you make two extra payments per year.
15 Year vs 30 Year Mortgage

• Illustration: 30 year mortgage; $150,000, amount (after down payment) and 3.25% interest.
• In 30 years, you’ll have paid $85,000 in interest.
• Payment is $652.81/month
• 15 years, 3.0%, same $150K:
• $1,035.87 payment
• $36,457 in interest
• Paid off in 15 years
Part VII. Invest and Give

• This is where non-retirement investment comes in.
• Risk capital!
• Also to be generous with your resources.