

What is a budget?

A budget is a document for recording actual and projected income and expenditures over time A budget forces you to consider

- What's important to you?
- Life is a series of trade-offs
 Belonging to health club or eating at nice restaurants
 Paying for your kids education or a new Ferrari
 Retiring at 50 or enjoying work until 65
 Having your spouse work or stay home with the kids
 Surget before a construction of 51000

 - Stay-at-home parent makes equivalent of \$100,000 a year
 Helping others less fortunate or helping yourself
- Living in a comfortable house or a mansion
- How do you want to live?
- What will it take to accomplish your goals?

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The budgeting steps

Budgeting is the **process** of setting

financial goals, forecasting future financial resources and needs, monitoring and controlling income and expenditures, and evaluating progress toward achieving the financial goals

Budgeting process

Setting goals

- Making life style decisions
- Gathering data
- □ Forecast future needs
- Implementing the budget
- Controlling your spending
- Evaluating your performance

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Setting goals

□ Set long-term goals (1, 2, 5, even 40 years)

- \$40,000 in 5 years for house down payment
- To be debt-free by end of year 3
- \$100,000 for college by daughter's 18th birthday
- Stock dividends = 10% of your salary by age 50

 $\square \mbox{Annually review, change, add goals}$

□Set short-term goals (<1 year)

Pay off Visa in 6 months

Need to be explicit – otherwise of little value
 YES => save \$3,000 by January for a new Shelby Mustang
 NO => save for car down payment – too vague

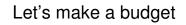
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Example of a long-term goal

□ Be able to buy a \$150,000 condo in 5 years

Assumptions

- Condo now costs \$150,000
- Housing prices will grow at 3%/year
- Earn 4% on your savings
- Want to buy in 5 years with 15% down
- General What you need and how to get it
 - Condo will cost 150,000(1.03)⁵ = 175,000 in 5 years
 - Down payment = .15x175,000 = 26,300
 - 26,300=PMT(FVIF_a-4/12%-5x12)
 □26,300=>FV .333=>i 60=>n solve PMT=-396.69
 - 26,300=>FV .333=>I 60=>n solve PM1=-396.69
 You need to save \$400 per month, every month
 - Round figures to make them more conservative



□Tools you'll need

- One Phillips head screwdriver (not included)
- Small notebook
- Green eye shade
 - □You are required to dress like an accountant when doing accounting work
- Graph paper or Excel either is OK
- Calculator
- Data
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Gathering data

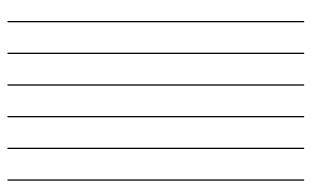
□Record all (<\$2.00?) your income and expenditures

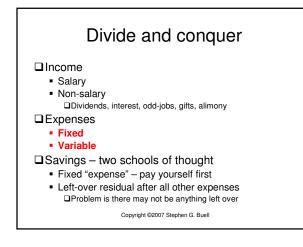
- Carry a small pocket notebook and jot them down
- Could be a real eye-opener for you \Box Keep all credit card receipts – file them away Given all debit card receipts - file them away □KISS principle applies

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DATE	PAYEE/PAYOR	AMOUNT	NOTES
9 – 1	Shady Pines Apts	1,150.00	Real
9 - 1	Lunch (Goose)	7.75	
9 – 1	Gas	45.80	
9 – 2	Lunch (Ho)	12.45	
9 – 2	Wegman's	85.79	Sale on cat food
9 - 2	LL Bean	56.80	Flocce top
9 - 3	Pally Ho	12.50	70m in tours
9 - 3	Beth. School Dist	1,312.50	Pay check
9 - 4	Direct TV	145.50	Promium package
9 – 4	Gas	44.00	Erme
9 - 30	Progressive Iusur.	214.89	Budget plan
9 - 30	Beth. School Dist.	1,312.50	Pay check

Paga from your notabook





Fixed expenses

Rent or mortgage

Utilities

- Consider "budget" plan of 11 equal payments plus a 12th adjustment payment (up or down)
- AC in summer and oil or gas in winter (could be a shock)

□ Insurance

- Consider "budget" plan if several policies with same agency
 - Life, car, homeowners, personal liability add up premiums and divide by 12

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More fixed expenses

Property taxes

 Usually required to be included as part of mortgage payment – good idea!

□School loans – usually at low rates

Don't be in hurry to pay off early

□ Savings

- Good idea to pay yourself first
- Don't treat savings as a passive left-over

Variable expenses

Food
Gasoline
Clothing
Health care
Entertainment / vacations
Personal and miscellaneous expenses

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More variable

Cable

Pay for 6 or 12 months in advance to save
 Newspaper

Climb into the bins on the subway platform
 Health club dues – pay in advance to save
 Church donation

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After two months of data

Organize and transfer notebook data

- Monthly is best control period to use
 Many expenses are monthly and you'll get paid monthly or semi-monthly
- Could use graph paper and make your own ledgers
- Could use Excel (after you've done it a couple of months)
- Could use Quicken or Microsoft Money
 Overkill in the beginning

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Bent	Fixed	EXPENSES	Savings	Trans & gas	Se V. Groceries	eptember ARIABLE EXPENS Entertainment 1463:0 56:00	ES Clothes				Difference
Bent	Fixed	EXPENSES	Savings	Trans & gas 45.60 44.00	Se V. Groceries 85.79 42.50	eptember ARIABLE EXPENS Entertainment 146.50	ES Clothes	40.00		1,312.50	Difference



Projecting future cash flows

Based on detailed records for a couple months of where your pay check went...

□ Make initial budget estimates

- Make realistic (conservative) estimates
 High on expenses and low on income
 Round expenses up and income down
 Use disposable take-home income
- Gross minus all taxes and employer withholdings
 Don't forget seasonal expenses

 B nieces and nephews @ \$40 each = \$320 in December
 Summer vacation \$1,000 plan so you won't need to charge

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Too easy to rationalize one-timers

Christmas only comes once a year
Boyfriend's birthday comes once a year
Ice hockey clinic is a great opportunity
The shoes were on sale

How often do I buy a new cell phone?

- □Maybe allow for some "mad-money" but not too much
 - Could keep you on your financial diet if you can cheat once in a while

Making some tough decisions

□Estimated expenses > estimated income □Either raise income or lower expenses

- Reduce eating out at restaurants
- Walk to work
- Buy used treadmill and quit health club
 Work at health club nights and weekends
- Cut back to basic cable
- Drink tap water instead of beer
- Buy solar powered Honda Civic

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Inflation and your budget estimates

□What if interest rates rise? □\$200,000 house with 10% down

□\$180,000 mortgage for 30 yrs @ i=5%

Monthly payment = \$966
 □180,000=PMT(PVIF_a - 5/12% - 30x12)
 180,000=>PV 5/12=>i 360=>n budget for PMT=\$966

□ 6 months later when you get mortgage @ i=6%
 Monthly payment = \$1,079
 □180,000=PMT(PVIF_a - 6/12% - 30x12)

Actually need PMT=\$1079
 Need \$113 more each month

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Planning for intermittent bad things

Holiday gifts, April taxes, summer AC bills, vacation, semi-annual car insurance

Insurance and utilities offer budget plans to smooth out expenditures

- Insurance 12 equal monthly bills
- Utilities 11 equal monthly bills + 12th adjustment □You'll know in advance if 12th is up or down
- □Vacation, gifts, taxes
 - Join vacation and Christmas clubs at bank
 - Essentially auto transfers each pay to specialized accounts
 Make your own specialized sub-accounts

Bank with Wachovia or the Buells

- I have \$150 automatically transferred each month to a Wachovia savings account used only for summer vacation
- □ I deduct \$150 each month from my checking account balance and put it in a "sub account" of checking for Christmas expenses
- □ I deduct \$125 each month from my checking account and put it in another "sub account" of checking for kids' clothing (hockey gear)

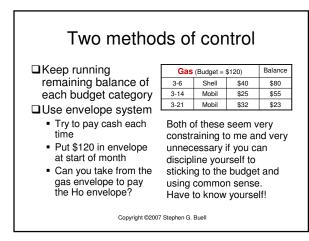
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Controlling your spending

Try to control where the money goes – reduce impulse spending

- How should you pay for stuff?
- □Checks easy to keep records, not always practical □Cash – not always practical and easy to waste cash
 - Keep going to ATM for cash lose control
 - Definitely record what you spent it on
 - Debit card the way of the future
 - Very easy to lose control of your money
 Must keep records of where the cash goes
 - Continually update checking balance

UVriting it down may cause you to think twice



Evaluating your performance

Examine short-term goals and how you're doing
Need to reduce expenses and/or increase income?

Adjust long-term goals accordingly

Got a surplus?

- Put into revolving savings fund to take care of seasonal deficits or put into real savings account
- Pay off credit card debt (highest interest)
- Pay down mortgage
- Put it in mutual fund

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Budgeting observations

□Much of this module is overkill

But still not a bad exercise to keep track of your expenses for a few months

Might find some surprises

Having key goals is good idea

I want a down-payment for house in 5 years
 Therefore, I need to save \$X a month

Budget plans for insurance and utilities help prevent unexpected shocks

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More observations

□Automatic transfers to holiday accounts, vacations accounts, etc. help

- "Sub-accounts" work for me
- Easier to budget if you never see the money

□If you're disciplined, use common sense

 Being anal retentive about budgeting could make you wealthy some day
 It could also suck all the fun out of your life