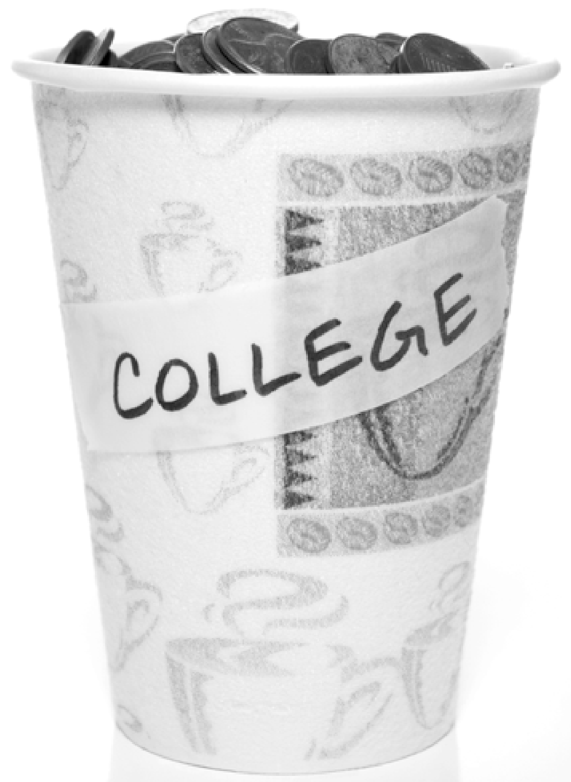
Introduction

Money Management

Do you know people who handle money carelessly? Lots of seemingly smart people are clueless about where they stand financially. There is Beverly, a professional woman, who calls the bank every two or three months to find out what the balance is in her checking account. She has never reconciled her checking account, so she never knows what her balance is. What Beverly still hasn't learned is that people at her bank don't know what Bev's real balance is either, because they don't know what checks Beverly has written that have not yet been cleared by the bank. Only Beverly knows that. And then there is Ben. Ben actually believes that he can write checks as long as he has blank ones to be used. Ben has been heard to say, "Why would the bank give me blank checks if I'm not supposed to use them?"

You don't have to be like Ben and Bev. You can get on the fast track to wealth by becoming good at managing money. To manage your money well, you need to know some basic information, use some common sense, and then take action. We recommend three steps.



First, get a grip on your spending. How can you do that? In the old-fashioned way. Set up a budget. Make a list of your income and expenses. Then subtract your expenses from your income. If you have any surplus cash, plan how you will use it. Do this each month. Maybe you will learn that now is the time to get started investing in a mutual fund or stock account.

Second, get to know the various services offered by financial institutions in your community. Checking accounts are among the most common financial services people use, but there are many others including ATMs, online banking, direct deposits, savings accounts, credit cards, installment loans, student loans, retirement accounts, and certificates of deposit. Among the many types of financial institutions, four important ones are commercial banks, savings and loans, credit unions and brokerage firms. Open an account now at one or more financial institutions. Start with checking and savings accounts, but don't wait long to start other, more rewarding savings programs. Becoming wealthy is within your grasp. Starting to save when you are young is a good idea.

Finally, learn how to protect yourself against risk. All choices involve risk, but some risks are greater than others. Buying insurance is a common way to reduce risk. There are many kinds of insurance to consider including auto, health, renter's, homeowner's, life, and disability. The type and amount of insurance you need will change as you get older and the value of your assets increases.

The best thing about these three tips and others covered in these lessons is that none of it is overly difficult. It might take some work, but you can learn this stuff. Your efforts now can have a big payoff later.

NAME: ______________________________ CLASS PERIOD: __________

Budgets Are Beautiful Call-In Show

Radio Host Budget Bob

Hello, financial health fans! Welcome to the nation's newest financial advice show, Budgets Are Beautiful. This is the radio call-in show that lets you, the radio listener, get the latest advice on how to manage your family finances. Today our topic is how to improve your skills at managing your family's finances. Our guest today is a successful family financial planner, Dr. Penny Saver. Dr. Saver has helped hundreds of families and has a Ph.D., M.A., and an S.U.V. Hello, Dr. Saver. Welcome to the show.

Dr. Saver

Hello Bob, and hello to all those people who are tuned in today. I am ready to take your questions.

Budget Bob

Here is our first caller: Connie from Connecticut. You're on the air, Connie.

Connie

Hi, Dr. Saver. I am having a disagreement with my husband regarding the meaning of some financial vocabulary. He heard someone on another call-in show talking about how to spend disposable income. My husband laughed and said that all of our income is disposable. He said that we dispose of all our income by the end of every month. Sometimes we dispose of our income before the end of the month. I think he was joking, but could you tell me: What do financial planners mean by disposable income?

Dr. Saver

Actually, your husband was not too far off. Disposable income is the money that you have left to spend or save as you wish after you pay your taxes, Social Security, and the other deductions that have been taken out of your gross pay. It is sometimes called net income. While disposable income can be used in many ways, most families have important financial obligations. Rent, car payments, and food bills add up quickly, so tough choices need to be made.

Budget Bob

That sounds kind of gloomy, Dr. Saver. Do you have any advice for Connie and her husband on how to get better use out of their disposable income?

Dr. Saver

Financial planners suggest that setting up and sticking to a family budget is the first step toward financial success. I advise families to start by setting a monthly budget.

To do this, you make a list of your income and expenses. Under income, list all the money you anticipate earning for the year. For most people, most income will be what they earn from their jobs. If your income varies month to month, divide your annual income by 12 and use the answer for the monthly income in your budget.

Then list your expenses. To help make sure your list of expenses is complete, look at last year's bills, credit card statements, and bank records. To capture the amount you spend on items you buy with cash, keep track of your out-of-pocket spending for a month or two on a small tablet. After you've done all this, you will have a good idea of where your money goes each month. Common expenses are rent, car payments, insurance, groceries, and so forth. Don't forget to list your savings amounts for each of your goals. If you wait to save what's left at the end of the month, you will never begin saving.

Now, subtract your expenses from your income. I hope that this is a positive number! If it is—if you have more income than expenses—then you have surplus cash that can be put to other uses. If, however, the number is negative, then you will need to cut your expenses, increase your income, or use some of your savings to get through the month.

Budget Bob

Here is our next caller: Calvin from California. You're on the air, Cal.

Calvin

Hello Dr. Saver. Thanks for taking my call. My wife and I started to write a monthly budget and we learned right away that not all expenses are the same. Some seem to stay pretty much the same each month while others change. Do other people have this same situation? Can you comment on the different types of household expenses?

Dr. Saver

Great question! Families ordinarily have what we call fixed expenses and variable expenses. Fixed expenses are ones that are relatively constant each month. These are a family's definite obligations such as a house payment, rent payment, car payment, and medical insurance. These expenses are hard to change in the short term, so we say they are "fixed." Variable expenses are ones that are likely to change in the short term. Examples include telephone bills, groceries, medical bills not covered by insurance, entertainment, recreation, charge account purchases, and so forth. These are expenses over which you have more short-term control. Occasional expenses or periodic expenses are those that occur once or a few times a year. Personal property taxes, income taxes, car insurance, birthday gifts and holiday gifts are examples of expenses that get some people in trouble because they forget to plan for them.

Budget Bob

Dr. Saver, I sometimes hear advisors say, “Pay yourself first.” In other words, set money aside from your disposable income to put into your savings plan. How does this idea of “pay yourself first” fit into the family’s expenses?

Dr. Saver

I tell my clients to include their savings goals in the fixed expenses part of their budget. I like this approach because it shows how important saving is to individual and family financial health. Under the saving part of the budget, a family or individual could list funds saved for emergencies, as well as other cash set aside for long-term savings and investments.

Budget Bob

Here is our next caller, Minnie from Minnesota. You’re on the air, Minnie.

Minnie

I just love this show, Dr. Saver. Here is my question. My sister Emily told me that she heard on television that people might have high incomes and still have a low net girth. What’s all this about net girth? Is it true that people who have high incomes are also thin?

Dr. Saver

Minnie, I think that you misunderstood your sister. I think she was referring to the idea of net worth, not net girth. Let me explain. People can have high incomes and still not be wealthy. When we measure wealth, we are measuring net worth. Here is how to figure your net worth. Net worth is determined by two factors. First, list your assets and their value. Assets are what a person owns, including the value of any savings, house, car, and personal possessions. Next, list your liabilities. Liabilities are the money you owe others such as payments on a home mortgage, car loan, credit card debt, college loans, and so forth. If your assets are greater than your liabilities, then you have a positive net worth. If your liabilities are greater than your assets, then you have a negative net worth. Individuals can have a large income and, because of their liabilities, still have a negative net worth.

Minnie

Can I follow up on that last point? Do you mean to say that you can’t tell whether a person is wealthy just by knowing where they live, what they drive, and where they travel?

Dr. Saver

That is exactly what I mean, Minnie. People who live in big homes, drive extravagant cars, and take around-the-world cruises probably have high incomes. That does not mean that they are wealthy. We measure wealth by calculating net worth. Many people of modest income have achieved a high net worth—many are millionaires—by living below their means.

Budget Bob

Well, Dr. Saver, that is all the time we have for today's show. Thank you for being with us.

Dr. Saver

You're welcome, Bob. Thanks for inviting me.

Budget Bob

Be sure to join us tomorrow when we will speak to Ms. Bonnie Bonds, another financial advisor. Bonnie's topic is "What Is Gross about Your Gross Income?" We hope you will tune in to the show tomorrow. We will be waiting for your call.

Questions:

a. What is disposable income?

b. What does Dr. Saver recommend as the three parts of a family budget?

c. What are fixed and variable expenses? Use examples to illustrate each.

d. What does "pay yourself first" mean?

e. What is net worth?

NAME: ____ CLASS PERIOD: ____________

John and Marcia: Monthly Spending Plan 1

John and Marcia are a young married couple. They have a two-year-old child named Ashley and a goldfish named Shark. John manages a local shoe store. Marcia recently graduated from college and is a manager-trainee at a local bank. Their combined monthly income is $5,200. They want to have a successful marriage, and they want to be financially successful.

John and Marcia have enough income to provide an adequate lifestyle. Their apartment is comfortable but not lavish. They take care of themselves, Ashley, and Shark with sensible diets, exercise, and medical care. They view maintaining health, life, disability, and renter's insurance as essential. They pay for child care at Terrific Tots Day Care so that both of them can work. They keep up with all their financial commitments, such as making payments on Marcia's college loan. They regard saving for retirement as important. Like other individuals, they are locked into their fixed expenses, but they have more flexibility with the variable expenses.

Marcia and John know that they want a second car. It is difficult to manage their complex schedules—work, day care, grocery shopping, and trips to the doctor—with only one car. They recently set a goal to save up enough money in one year for the down payment on a second car.

John and Marcia are regular savers. They practice the idea of "paying yourself first." They currently have $175 withheld each month from their paychecks to provide a fund for emergencies. They plan to have $400 taken from their paychecks each month for the next year to enable them to make a $2,700 down payment on the second car.

Listed below are the "before" and "after" fixed expenses. The only item that has changed in the **After** column is "Savings withheld." Go to the listing of John and Marcia's variable expenses. Figure out where John and Marcia can draw the additional money for savings from their variable expenses. Also, answer the questions at the end of this exercise.

Monthly Budget	**Before**	**After**
Total Income (both spouses work)	**$5,200**	**$5,200**
Fixed Expenses		
Housing	750	750
Life and disability insurance	325	325
Renter's insurance	15	15
Automobile insurance	80	80
Student loan	100	100
Savings withheld	175	400
Federal and State taxes	630	630
Social Security	400	400
Pension fund withheld	80	80
Total Fixed Expenses	**$2,555**	**$2,780**

Variable Expenses	**Before**	**After**
Meals (at home)	300	
Meals (away from home)	250	
Utilities	315	
Automobile fuel, maintenance	290	
Medical care	230	
Child care	205	
Clothing	195	
Gifts and contributions	60	
Magazines and newspapers	10	
Home furnishings and appliances	200	
Personal Care	50	
Entertainment	260	
Vacation	120	
Credit Card	100	
Miscellaneous/personal	60	
Total variable expenses	**$2,645**	
Total expenses	**$5,200**	**$5,200**

Questions:

a. What are some examples of John and Marcia's fixed expenses?

b. What are some examples of John and Marcia's variable expenses?

c. John and Marcia have decided to practice the "pay yourself first" approach to saving for a second car. How do they pay themselves first?

d. Examine John and Marcia's monthly spending plan above. What sacrifices do you think John and Marcia should make in their variable expenses to meet their goal? Note: At-home food expenses can't be reduced below $220.

e. What are the benefits and costs of your recommended decisions for John and Marcia?

NAME: ____ CLASS PERIOD: ____________

John and Marcia: Monthly Spending Plan 2

One year later, John and Marcia are pleased with their financial decisions. They have been able to reduce their expenses to purchase the second car. They have enjoyed the convenience of owning a second car, their income has increased, and Marcia's college loan has been paid off. But new challenges have arrived. The car payment is greater than the college loan was. While having two cars has made life much better, the extra car has added to insurance and car expenses. Also, increased income means the couple pays more in taxes and Social Security.

Marcia and John know that to be financially successful they need to begin acquiring better assets. Owning a home is on the top of their personal and financial wish list. They have set a goal to save $15,600 in four years for a down payment, closing costs, and other expenses related to the purchase of their home. They had been saving $400 per month in order to afford a down payment on a second car. They now plan to have another $100 taken out of their paychecks for the next year to start their down-payment fund for a home. Note that $175 of this monthly saving is set aside for emergencies.

Listed below are the **Before** and **After** fixed expenses for John and Marcia's new savings plan. The third column represents their anticipated expenses as homeowners. The only fixed expense that will change is "Savings withheld." Figure out where they can draw the additional money for savings from their variable expenses. Enter your new amounts in the chart on the next page. Also, answer the questions at the end of the exercise.

Monthly Budget	Before	After	Homeowners
Total Income (both spouses work)	**$5,400**	**$5,400**	**$5,400**
Fixed Expenses			
Housing (rent or own)	750	750	840
Life and disability insurance	325	325	325
Homeowners insurance and taxes	15	15	210
Automobile insurance	130	130	130
Car loan	400	400	400
Savings withheld	400	500	400
Federal and State taxes	670	670	420
Social Security	415	415	415
Pension fund withheld	100	100	100
Total Fixed Expenses	**$3,205**	**$3,305**	**$3,240**

Variable Expenses	Before	After	Homeowners
Meals (at home)	315		
Meals (away from home)	150		
Utilities	300		
Automobile fuel, maintenance	400		
Medical care	230		
Child care	175		
Clothing	75		
Gifts and contributions	50		
Magazines and newspapers	15		
Home furnishings and appliances	40		
Personal Care	70		
Entertainment	180		
Vacation	100		
Credit Card	30		
Miscellaneous/personal	65		
Total variable expenses	**$2,195**	**$2,095**	**$2,160**
Total expenses	**$5,400**	**$5,400**	**$5,400**

Questions:

a. What is John and Marcia's new financial goal?

b. Examine the monthly spending plan above. What sacrifices do you think John and Marcia should make in their variable expenses to meet their goal? Enter new amounts for spending in the **After** column of Variable expenses. Note: At-home meal expenses cannot be reduced below $220.

c. What are the benefits and costs of your recommended decisions for John and Marcia?

EXERCISE
8.3

NAME: ______________________________________ CLASS PERIOD: ___________

Can John and Marcia Afford the Home of Their Dreams?

John and Marcia are saving money for a $10,000 down payment on a $150,000 home. In addition they are saving money to cover other costs (such as closing costs) that will be incurred when they purchase their new home. Use the new information below to determine whether John and Marcia can afford the home of their dreams.

New Information:

Use the table on the next page to determine the monthly house payment for a 30-year, fixed-rate mortgage loan at 6 percent. What would the monthly payment be for this loan? ______________ (Hint: $150,000 – down payment = loan amount.)

To use the table, go down the column on the left to find the loan amount you want and follow across to the interest rate available. The figure on the table represents your mortgage payment of principal and interest (PI). For example, a $100,000 mortgage with an interest rate of 6.5 percent would have a monthly payment of $632.

The monthly payment covers Principal and Interest (PI), but John and Marcia also would need to pay for insurance and real estate taxes (TI), which total $210 each month. So their total house payment, which includes PITI, equals _______________.

As homeowners John and Marcia will have to pay higher utility costs. They expect to budget $365 per month for utility payments.

One of the benefits of homeownership is the ability to reduce your income taxes by deducting mortgage interest expenses. If they become homeowners, John and Marcia will pay $3,000 less annually in state and federal income taxes during the first year (which means their fixed expenses in this category would decline by a monthly amount of $250).

Loan Amount	Interest 6%	Interest 6.5%	Interest 7%	Interest 7.5%
$100,000	$600	$632	$665	$699
$110,000	$660	$695	$732	$769
$120,000	$720	$758	$798	$839
$130,000	$780	$822	$865	$909
$140,000	$840	$895	$932	$979
$150,000	$900	$948	$1,049	$1,101
$160,000	$960	$1,011	$1,065	$1,119
$170,000	$1,020	$1,074	$1,131	$1,189
$180,000	$1,080	$1,138	$1,198	$1,259
$190,000	$1,140	$1,201	$1,264	$1,328
$200,000	$1,200	$1,264	$1,331	$1,398

Questions:

Do John and Marcia have enough flexibility in their budget to accommodate the additional costs of homeownership (mortgage payment, taxes, insurance, and higher utilities)?

If not, what are some expenses they may need to reduce in order to afford the home they want? Enter their new variable expenses related to owning a home in the Homeowner column in the budget form from Exercise 8.2B.

A rule of thumb for some lenders is to qualify you for a mortgage if the payments you would incur meet two criteria: a) the mortgage payment with taxes and insurance will be less than 28 percent of your monthly gross income, and b) the monthly mortgage payment of principal, interest, taxes, and insurance plus other monthly consumer debt (such as a car loan and credit card payments) will not exceed 36 percent of your gross monthly income. Would the loan John and Marcia are considering meet these lending criteria?

$5,400 x .28 ______________________

$5,400 x .36 ______________________

Do you think John and Marcia can afford to pay 28 percent of their monthly gross income as a monthly house payment? Why or why not?