IN THIS CHAPTER

» Tracking your expenses

» Calculating your income

» Exploring your financial goals

» Creating a budget to help you manage your money

Chapter 1 Managing Your Money

A budget is the first step to living within your means and, even more important, living the life you choose. Knowing your expenses, your income, and your financial goals is the foundation. In this chapter, we ask you to grab a notebook — or create an easy spreadsheet on your computer — to find out just where you stand financially so that you can move forward with financial awareness and stability.

We start by taking a look at expenses. How much do you spend each month? What are fixed expenses — those bills you pay regularly? What about variable expenses — those that fluctuate? Think about the difference between basic necessities and luxuries — needs versus wants.

Next, we look at income. How much do you earn? Do you have investments? Other streams of income? If you're older, do you have retirement income?

Plus, we set our sights on the future. What are your financial goals? Going out to dinner more often? Fixing the roof? Visiting family more often or going on that dream vacation?

These are the types of questions you look at in this chapter. And, with the answers to these questions, you can begin to create a budget. When you become financially aware, your life can change in ways small and big. You can make room for things that matter so you're living life on your terms.

Seeing Where Your Money Goes: Your Expenses

Tracking your expenses for a month or longer can show you exactly where your money is going. Write down what you spend in cash, by check, and through payment services such as CashApp, PayPal, and Venmo. Review your debit and credit card expenditures. Then look at periodic — including quarterly and annual — expenditures such as taxes, homeowners or renters insurance, and vacations. You'll most likely discover spending patterns, some of which may surprise you. Perhaps you realize you're spending way too much in a category, like takeout meals or multiple streaming services. Or maybe you find that your medications are depleting your income, and you want to look at discount cards or different insurance options.

Identifying fixed expenses

Fixed expenses are approximately the same amount of money every billing period, such as your rent or mortgage and car payments. Fixed expenses are paid weekly, monthly, quarterly, or annually. For example, you may pay for your car registration every year or two and your car insurance monthly or quarterly. Weekly fixed expenses may include things like a parking or commuter pass. Figure 1-1 shows various examples of fixed expenses.

Fixed Expenses

Housing

- Rent
- Mortgage
- Property taxes
- Homeowners association or condo fees
- Internet
- Electricity
- Water
- Landline
- Gas
- Lawn maintenance

Insurance

- Disability insurance
- Health insurance
- Life insurance
- Renters or homeowners insurance
- Vehicle insurance

Medical

- Flexible spending account
- High-yield savings account

Work

- Public transportation
- Parking
- Professional association fees

Personal

- Gym and other memberships
- Newspaper and magazine subscriptions
- Streaming services
- Cellphone
- Car payments
- House of worship

Children

- Childcare
- Tuition
- 529 and Coverdell savings accounts
- After-school activities

FIGURE 1-1: Spending categories that are considered fixed expenses.

Allowing for variable expenses

Variable expenses, or *variable costs*, unlike fixed expenses, vary from month to month and may be items you regularly purchase or ones you buy only occasionally (see Figure 1-2). Common variable expenses include areas like the following:

- Groceries
- Gas for your car

- Food for your pets
- Items for any hobbies
- Personal care items like hygiene products or makeup

Variable Expenses

Food

- Groceries
- Dining out
- Lunch (work and school)
- Coffee

Transportation

- Gas
- Tolls
- Oil changes and other maintenance
- Car repairs
- Bus and train fare
- Parking

Leisure

- Concerts
- Movies and museums
- Books
- Hobbies
- Games for family
- Vacations

Household

- Pet food and supplies
- Veterinary care
- Cleaning supplies
- Decor
- Home maintenance and repairs

Miscellaneous

- Clothing
- Haircuts
- Charitable contributions
- Gifts
- Medical co-pays and out-of-pocket expenses
- Sports, lessons, tutors, school field trips

FIGURE 1-2: Spending categories that are variable expenses.

These types of expenses can be more challenging for you to track. Depending on the time of year or stage of your life, your spending in these categories can fluctuate. You may spend nearly nothing in a category like household items one month and then easily spend a few hundred dollars there the next month. You may spend a lot more money during the holiday season between vacations and gifts.

Once you've tracked variable expenses for a few months, you'll have an easier time assigning a monetary value to them. A category may occasionally spike, initially throwing everything you had planned off course. You're going to figure this all out.

Calculating your total spending

Now you're ready to evaluate what you spend every month. Grab your notebook or open up your spreadsheet and follow these steps:

1. **Make a list of your fixed expenses.**

   In addition to your housing expenses, list car payments and fun things like gym memberships, subscription boxes, and streaming services. Divide these into categories. For instance, under housing you'd put mortgage or rent, homeowners or renters insurance, and utilities.

2. **Make a list of your variable expenses.**

   Just as you did for fixed expenses, put your variable expenses in categories.

3. **Add up the total monthly costs for fixed expenses each month.**

   You now clearly see how much you spend every month on your fixed expenses. Once you've done this for a few months, compare your fixed expenses month over month.

4. **Add up the total annual costs for variable expenses.** Because these are periodic, not monthly, you'll need to gather your expenses over time to see your annual costs. To get a monthly estimate, divide by 12.

5. **Evaluate whether you need those expenses.**

   Consider whether all your expenses are necessary. Do you need to spend money on a gym membership every month, or can you find a cheaper way to work out, such as walking on local trails? If you've signed up to get monthly items or deliveries, do you have the option to pause them and work through your current supply instead?

   Assess your larger expenses, too — not just the minor ones. For example: You realize rent may be costing you more of your take-home pay than you're comfortable with. Moving can be expensive, but make a note to research other living arrangements when you get closer to the end of your lease.

Understanding needs versus wants

Fixed and variable expenses can include both needs and wants:

- Generally speaking, *needs* include categories such as rent or mortgage payments, food, gas to get to and from work if you commute, and health care, including medicine.
- *Wants* are things like eating out, getting a new cellphone when your current one works fine, and going to concerts and movies.

Consider ways to save on both needs and wants. For instance, on needs, look for weekly specials at the grocery store. For wants, find deals at the cosmetic counter.

The difference between needs and wants can get murky quickly, especially because one person's want may genuinely be another person's need. Spending money on your wants is perfectly okay; you just need to figure out how to budget for them.

Be realistic when determining your wants and needs. Suppose you have a specific life situation that requires you to spend a bit more on your variable expenses. If so, budget for it. Perhaps you have a busy, stressful job. Maybe getting a massage once a month and ordering takeout a few times a week makes your own and your family's life manageable. Perhaps you pay more in a specific category, like eating out, than people say you should. But being realistic about your spending will help keep you on budget.

Knowing Where Your Money Comes From: Your Income

Your *income* is an essential component of your budget. Knowing how much money you have coming in helps you make sure your expenses don't exceed your income. It can also help you set realistic goals for all areas that relate to your finances and perhaps even quality of life. When tracking your income, you may realize you have more than you initially thought you had. On the other hand, when you look at your income and expenses, you may find you have a spending deficit, which means you need to find ways to either cut back or earn more.

When discussing your work income, one dollar amount you need to keep in mind is your *net pay*. Net pay is the amount of money left after any withholdings you may be subjected to, such as federal and state taxes, FICA taxes (supporting Social Security and Medicare), health insurance, and any wage garnishments you may be paying off. Your net pay is the money you have to pay your fixed and variable expenses and put toward savings and your goals.

Your income may also include earnings from your investments and other sources such as, if you're older, retirement income.

Depending on a monthly income

The first type of income you should consider is what you earn monthly to cover all your expenses. *Monthly income* can come from various sources. While it can be consistent, it can also be different from month to month. Here's a list of different types of monthly income you can earn:

- **Income from full-time and/or part-time employment:** This is income you receive from an employer that has you on its payroll. Some jobs pay a *salary* — a flat amount of money per paycheck — and others pay an hourly *wage.* Unlike a salary, hourly income can fluctuate because the number of hours you work may vary.
- **Income as a self-employed freelancer or consultant:** Freelancers and contractors are considered self-employed, but the main difference is that *freelancers* generally balance more than one client and work on projects with a short timeline. *Contractors* often work with one main client on a longer time frame. (For tax purposes, there is no distinction between the two.)
- **Pensions and other paid retirement plans:** A *pension* is a type of retirement program that an employee, an employer, or both pay into. The plan pays a fixed sum to the employee at regular intervals upon retirement. Some pensions require you to work for the company for a certain number of years before you're eligible (or *vested*). Federal, state, and local government or other public sectors also allow for paid retirement plans.
- **Self-funded retirement plans:** Outside of traditional pensions or government-paid retirement plans, you may receive payments from retirement accounts, such as 401(k)s, 403(b)s, and IRAs. These types of retirement accounts allow you to save for retirement by investing.

- **Social Security retirement benefits:** When people talk about receiving Social Security, they're usually referring to retirement benefits. Every year you remain in the workforce, you can receive up to four work credits. After you've earned 40 credits, you're eligible to collect benefits. When you can start receiving Social Security retirement benefits depends on when you were born. The longer you wait to receive benefits, up to age 70, the larger your payments. For up-to-date information, visit `www.ssa.gov/retirement` or see AARP's *Social Security For Dummies.*
- **Social Security Disability Benefits, Supplemental Security Income, and survivors benefits:** Social Security has three other benefits. If you're disabled, you can receive two different types of benefits.
  - *Social Security Disability Insurance (SSDI)* benefits are granted when you meet the Social Security Administration's definition of having a disability and you have earned enough workforce credits, depending on the age you become disabled.
  - If you've never worked due to a disability, you can qualify for *Supplemental Security Income (SSI)*.

  Last but not least, if you're a child, spouse, or parent who relies on someone in the workforce to support you and that person dies, you may be eligible for *survivors benefits.*

  You can create a Social Security account at `www.ssa.gov/myaccount`. Doing so allows you to check your workforce credits and the money you've paid into Social Security and to get an estimate of your retirement benefit payment. You can also check to see what other Social Security benefits may be available to you, such as disability insurance or survivors benefits, along with the amount you or a loved one would qualify for. This information can help you budget better for life circumstances and save for retirement.
- **Cash benefits from the state:** You may qualify for cash assistance in some states, depending on your situation. Temporary Assistance for Needy Families (TANF) is one example. Along with cash assistance, other benefits you may be eligible for are work assistance, specific training to enter back into the workforce, and help with childcare. Find out more at `www.benefits.gov/benefit/613`.

You Gotta Have Dreams: Financial Goals

You'll want to set aside money for emergency expenses. But you'll also want to set financial goals. Goals can be simple, like going to a concert once a month. They can be moderate, like treating the family for dinner every Sunday or saving enough so you can retire comfortably. They can also be ambitious, like taking a dream vacation. After you're clear on your financial goals, figuring out the steps to get you there is easier.

Setting financial goals can help you live a better quality of life, which can mean the difference in where you can afford to live, what you do in your free time, whether you can take a leave of absence due to a life-changing emergency, and when you can retire.

Saving for your future

Life is short, and putting money aside for your future sets you up for long-term financial security — and happiness. In addition to retirement accounts, you may need a new car for transportation to and from work. Maybe the perfect home of your dreams hits the housing market, and you see yourself establishing some roots! You may have kids or grandkids heading off to college — or you may want to go back to school yourself to make more money so you can have an even sounder budget than before. Somedays can turn into your current day, so you may as well plan for them.

Saving for the future can also include fabulous trips you want to experience, like sightseeing in Europe or wine tasting in Napa. Maybe it's establishing a scholarship fund in someone's name at a local nonprofit, redecorating your house, or buying a muscle car to restore. Your future needs to include fun, and your budget helps you do just that.

Make sure your goal is actually yours. You may hear, for example, that the way to make the most money is to become your own boss. It may not be as easy as some people claim. Many people quit their jobs to become entrepreneurs but don't have a clear plan or realize they aren't suited for self-employment at all. Make sure whatever financial goal you choose is one that you want to achieve, so you'll put in the hard work to make it your reality.

Paying down your debt

Another financial goal you may want to set is paying down your debt. Debt isn't evil if you use it strategically. But having even strategic debt can cost thousands of dollars in interest and financing fees. Setting a financial goal to pay your debt down, no matter how slowly, can help in the long run. Because as soon as you pay off that debt, you have more cash flow to do things that are important to you.

Putting your financial goals in place

Setting financial goals doesn't have to be complicated. Just follow these steps:

1. **Establish what your goals are.**

   For example, maybe you want to buy a house.

2. **Make the goal as clear as can be.**

   Decide precisely how much money you'll need to buy that house and when you want to be able to make the purchase.

3. **Take actionable steps toward completing it.**

   Examples of actionable steps may be slowly paying off your credit card so that eventually you can open a high-yield savings account for the house you want. Every little bit adds up, so don't be discouraged if you have to start small. With every action, you move the needle closer to your goal.

Creating Your Budget

After you've set out your expenses, income, and financial goals, it's time to put it all together. In your notebook or on your spreadsheet, you've set out your three components:

- Expenses (how much money you spend), both fixed and variable
- Income (how much money comes in)
- Financial goals (things you want to accomplish, such as retiring, paying down debt, and saving for something in the future)

Now you probably see that all three are equally important. Your expenses can affect how much income you need to bring in, which determines whether you can accomplish your goals by working one regular full-time job or also getting a side gig. Your income determines how much money you can spend on your lifestyle or put toward your future, like vacations or retirement. It's all related, so the sooner you figure out what you need to pay and what you want to accomplish, the faster a budget will work for you.

Add up your income and subtract your expenses. Perhaps as you see your budget in full, you realize your net pay doesn't cover all your monthly expenses or the goals you've set for yourself. In these cases, you have to either cut your spending or increase your income.

Finding ways to cut your expenses

Here are some ideas—and you'll find 500 more in later chapters!

- See whether you can get a better rate by paying for certain things, like insurance, annually rather than monthly.
- Call your providers, such as cellphone or internet, to see whether you qualify for any discounts or loyalty rates. Sometimes saying that you're preparing to move to another provider will prompt the offer of a discount.
- Research competitors for insurance policies: healthcare, automobile, renters or homeowners, and life.
- Consider switching to different tiers of subscription services, such as home streaming networks.
- Discuss options with your landlord or mortgage company.

Nothing is off the table; the more money you can free up, the more you have to save for your goals or spend on things that bring value to your life.

Identifying additional sources of income

The economy can be volatile. A job may be here one day and outsourced the next. Or your needs and circumstances can change. This section offers a few ways you can earn additional income.

Earning rental income

Renting a room is a common way to break even on your living expenses. Collecting the monthly payment from a roommate is considered rental income. You can also earn rental income if you're a landlord or have investment properties you collect earnings on.

Another way people earn this type of income is by renting their residences as short-term vacation rentals. With websites such as Airbnb and VRBO, you can rent out a room in your home or the entire house for a nightly fee.

Taking part-time gigs

You can earn extra income by doing odd jobs or selling stuff. Here are some common side hustles:

- Shop and deliver groceries or restaurant meals.
- Sell items you have laying around or buy items for a lower price and then sell them for a profit on sites like Amazon, eBay, and Facebook Marketplace.
- Create content online as a writer.
- Make crafts and sell them on a site like Etsy, Handmade Artists, Facebook Marketplace, or other social media.
- Put together furniture.
- Babysit kids.
- Be a companion for older people.
- Dog-walk and pet sit, either at your house or theirs.
- Drive for rideshare services.

Setting aside money for taxes

Income from side gigs may be considered earned income depending on the source, so check with the IRS to see whether you need to put money aside for taxes. If so, save 25 to 30 percent of any income earned from side hustles in a checking account. Pay your estimated taxes quarterly and save anything left over for business expenses. You may be able to deduct certain expenses on your taxes. For more information on self-employment taxes, visit `www.irs.gov`.

Like anything in life that you're trying to improve, things may feel uncomfortable in the beginning. Finding out you spend far more than you earn, for example, can be discouraging. But keep this in mind: Knowing your expenses and income and creating a realistic budget can have a cascading effect and improve all areas of your life.

Celebrate the small wins, and know your future is more financially stable every day.