

Building a Budget and Savings Plan

Terri Dougherty



Money and Finance Guide



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Contents

Introduction	4
The Freedom of Budgeting	
Chapter One	7
Where Do I Start?	
Chapter Two	15
Building a Budget	
Chapter Three	28
Realistic Expectations and Long-Term Goals	
Chapter Four	41
How to Find the Sweet Spot	
Chapter Five	50
The Unexpected: Be Ready for an Emergency	
Chapter Six	61
Bouncing Back	
Source Notes	70
For Further Research	73
Index	76
Picture Credits	79
About the Author	80

Chapter Two

Building a Budget

A budget is your plan for spending money, but it's about more than paying bills. A budget puts you in charge of your finances, gives you control over your spending, and helps you reach savings goals. Creating a spending plan lets you make choices that help you worry less and enjoy life.

As twenty-six-year-old Rachel found, it can also keep you from making spending mistakes. Rachel, a structural engineer, was eager to furnish her first apartment. She saw a couch she thought was cute and didn't really think about how much it cost. "I paid a lot for it because I didn't know how much couches were supposed to cost. I literally bought the first cute one I saw online," she says. "Then it ended up being really uncomfortable, and was too short for me to even lie down on." When she moved into an apartment that already had a couch, she sold the couch for half price. Her lesson? A budget can help you think twice before making a costly purchase you regret. "If you don't research and don't think about it first, it's surprising how easy it is to spend money,"¹⁰ she says.

"If you don't research and don't think about it first, it's surprising how easy it is to spend money."¹⁰

—Rachel, age twenty-six

A budget gives you the opportunity to think through purchases and manage your finances. It also helps you do the following:

- avoid credit card debt
- save for things you want
- prepare for emergencies
- ease financial uncertainty
- take away guilt over spending money

As Rachel found, planning your purchases helps you make decisions you're happy with. Making the effort to create a budget pays off with better spending habits and peace of mind.

Looking at Income

Before creating a spending plan like Rachel now has, you need to look at how much money you have coming in and where it's currently being spent. This gives you the foundation for creating a budget and deciding where you want your money to go.

You might think that you don't need to learn about budgeting right now because you don't have a lot of money coming in. However, it's never too soon to get insight into good financial habits. Budgeting now allows you to practice money management. You'll gain experience you can build on as your income grows. Sure, you might make mistakes, but they'll be less costly now than if you make them when your income is higher.

Budgeting doesn't hinge on having a certain amount of money to spend. It's about figuring out how to make the best decisions with what you have. For example, Sara, age eighteen, gets most of her income from her job at a fast-food restaurant. Nick, age fifteen, earns income in the summer by mowing his family's lawn. You might get income from an allowance for work you do around the house, gifts for your birthday and holidays, or babysitting for neighbors.

To estimate your income each month, list all the ways you get money. If you have a job, look at the pay stubs to see how



A part-time job is a great way to earn income so you can reach your personal savings goals.

much you bring home with each paycheck. The amount on your check is your net income (the amount you receive after taxes and other deductions are taken out) for that pay period. Most people are paid every two weeks (bimonthly), but a paycheck might also come every week or every month. When adding up your monthly income, include all of the money you get from your job and other

sources that month. Multiply that by the number of times you receive it each month to get the total. It might look like this:

Source of income	Amount	Multiply by number of times received each month	Total
Job	\$45	2	\$90
Babysitting for neighbor	\$30	1	\$30
Allowance	\$10	4	\$40
Total monthly income:			\$160

Why If I Don't Know How Much I'll Make?

If you work at a job where you earn tips, or if your hours at work vary, your income could be different from week to week or month to month. To get an idea of how much you'll be bringing in, look at the average amount you've brought in over the past few months. Use this as a starting point, and adjust your budget if your income changes.

Eric, age twenty-eight, is a self-employed automotive journalist who has been budgeting for a variable income for several years. He's usually paid in the month after his assignments are finished (for example, he's paid in May for assignments he finished in April). He bases his income estimate on the payments he's expecting. He finds it helpful to have a different budget for each month, based on the income he expects and the expenses he's planning for. Eric says:

"My advice for people who are budgeting with a variable income is to have that written budget unique to each month."¹¹

—Eric, age twenty-eight

My advice for people who are budgeting with a variable income is to have that written budget unique to each month and to adjust that income column every time you get a

new assignment and can make an accurate estimation of when you'll be paid for it. . . . It might sound hard to predict your income, and it is at first. I learned how to budget mostly by trial and error and it took a few months to really figure out how to do it right.¹¹

Track Spending to Find Out Where Your Money Is Going

Eric also breaks down his expected expenses each month, using a spreadsheet to list how much he'll spend on things like insurance, utility bills, and subscriptions. His spreadsheet also has columns for debt (his mortgage payment), savings, and donations. In addition, his spreadsheet includes expenses that are unique to that month. In May, for example, he budgets for gifts for Mother's Day and his son's birthday.

Eric has been budgeting for a while, so he has a good handle on how much he spends each month on various items. To find out where your money is going, track your spending. This lets you

Spending Surprise

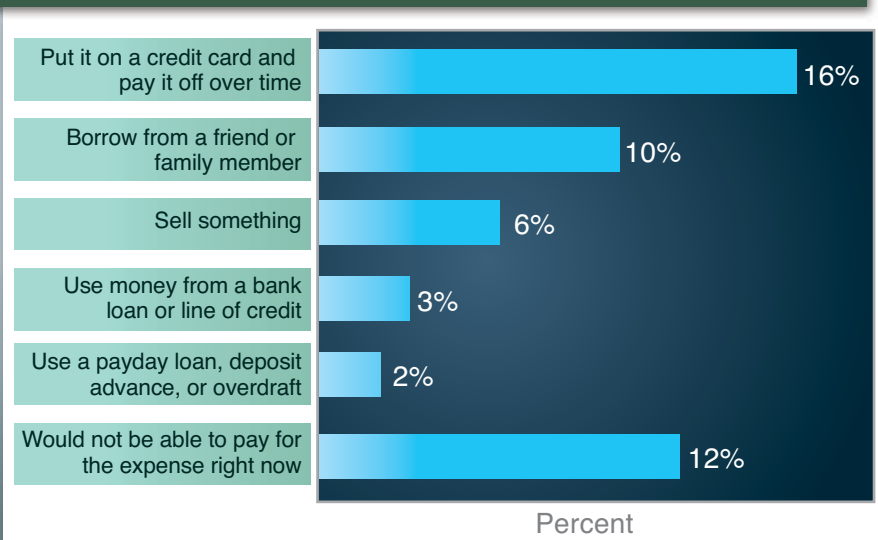
No matter how much money you make, the amount you're spending can come as a surprise if you don't keep track of it. The importance of watching spending didn't occur to Mario Fernandez until he lost his job. An oil field rig supervisor in Texas, he was laid off in the spring of 2020 when demand for oil fell as people stayed home to avoid the COVID-19 virus. Workers like Fernandez who had made \$100,000 or more a year were laid off. "I didn't realize how much I spent when I was at work," Fernandez told National Public Radio. "Breakfasts. Lunches. Buying my crews food." He wanted to reward his workers for their hard work, but he hadn't realized how much it was costing him. When his income disappeared, he realized how much he had been spending.

Quoted in John Burnett, "Historic Oil Bust Delivers a Gut Punch to a High-Flying Texas County," *Morning Edition*, National Public Radio, May 11, 2020. www.npr.org.

Small Expenses May Result in Hardship

A 2019 survey conducted by the U.S. Federal Reserve Bank revealed that relatively small, unexpected expenses can be a hardship for many families without adequate savings. Faced with an expense of \$400, most respondents said they would carry a balance on a credit card or borrow from friends or family. Twelve percent of adults said that they would be unable to pay the expense at all.

Other ways individuals would cover a \$400 emergency expense



Note: Respondents can select multiple answers.

Source: www.federalreserve.gov.

emotions will be involved. If you get into a car accident, break your phone, or lose your job, you might experience anxiety, frustration, sadness, and anger. These emotions should not be ignored. You can deal with them by talking to family, friends, or a counselor.

Having an emergency fund will make it easier for you to work through the financial side of the situation. It's important to be proactive and take steps to deal with the costs you're facing. Trying to avoid bills or constantly planning to deal with them later will

One Step at a Time

If building a well-stocked emergency fund of several thousand dollars seems daunting, try reaching smaller goals first. For example:

- Step 1: Save one month's rent.
- Step 2: Save \$1,000.
- Step 3: Save one month's expenses.

"We are incrementally building this savings," notes financial counselor Becky Smith. "If I tell someone to save one month's rent and they can't do it, I'll tell them to try to put \$20 in savings next month." This allows steady progress to be made toward the goal. For example, if your monthly rent is \$500, you can reach this goal in about six months if you save \$20 per week. If you keep going for the rest of the year, you'll reach step 2 and have \$1,000. Then you can aim for step 3.

Becky Smith, interview by the author, March 28, 2020.

only make the problem bigger. Missed payments bring fees and added interest. Do your best to assess your financial situation and come up with a plan.

When an emergency arises, figure out how long your emergency fund will last or how much of the surprise expense it will cover. If it won't cover everything, take action. Ask about payment plan options, turn to family and friends for loans, look for ways to cut back on spending, or bring in cash by selling furniture, a bike, or a car. These solutions are not ideal, but they are better than allowing bills to mount. A financial emergency will involve dealing with change and uncertainty. Taking steps to get the financial side figured out will provide a sense of control and allow you to have more energy to focus on the other aspects of the situation. Once things settle down, learn from the situation and restock your emergency fund.

Source Notes

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1. Becky Smith, interview by the author, March 28, 2020.
2. Smith, interview.
3. Smith, interview.

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5. Quoted in author questionnaire, "Building a Budget and Saving Money Survey," Survey, March 16, 2020.
6. Smith, interview.
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8. Quoted in author questionnaire, "Building a Budget and Saving Money Survey."
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11. Eric, interview by the author, May 11, 2020.
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13. Quoted in author questionnaire, "Building a Budget and Saving Money Survey."
14. Eric, interview.

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Index

Note: Boldface page numbers indicate illustrations.

avoidance of money
attitude, 47

Bolt, Larry, 53

budgeting
importance of, 6, 11-12, 14
as practicing money management, 16
as problem solving, 8-9
for surprise purchases, 37
tools for, 27
zero-based, 22

budgets, 5
See also spending plans

car purchases, 65

cash, using
credit cards costs and, 29
envelope system and, 38
spending awareness and, 36

charitable giving, 44-46, **46**, 64

credit cards
cost of using, 29

using, to cover
emergencies, 52-53

debit cards, 40

debt, 24, **24**

emergency funds
amount to have, 55, 56
deciding when to use, **59**, 59-60
reasons for needing, 50-52, 53, **57**

envelope system, 38

expenses
cutting down on, 23
keeping track of, 19-21, **21**

saving for big, 23
categories of, 21
subtracting income from, 22, **22**

types of, 23-24, **24**, 25, 44-46, **46**
unexpected, 50-51, **57**

Federal Trade Commission
budgeting tools, 27

Fernandez, Mario, 19
50/30/20 rule, 23-24, **24**, 44

About the Author

Terri Dougherty has written dozens of books for young adults and children. She lives in Appleton, Wisconsin, with her husband. They have three grown children who are learning more about budgeting every day. Terri loves picking up and passing on new tips about how to save money.