

Twelve Month Budgeting

Presented by Dick Bell to the National MS Society "Relationships Matter"
Audioconference on March 6, 2008

It's a well-known axiom that people don't plan to fail ... they fail to plan. And they give less time to planning their finances each year than they give to planning a weekend vacation.

If I could see through our telephone lines and I asked for a show of hands of all those who really like the word "BUDGET", I'll bet you'd all be sitting on your hands.

We tend to think of a budget as restricting us, as in "Oh no, now I have to keep track of every nickel I spend". But, just for this phone call, let's change our attitude. A budget is not going to restrict us ... it is going to "free" us.

A budget is nothing more than a savings and spending plan. And the goal of such a plan is to get us to direct our dollars to where they will be the most appreciated.

Bill Bachrach is a professional speaker and sales trainer and his opening line when he is talking to anybody about financial matters is: "What Is Important About Money To You?" And no matter what answer Bill gets, he asks: "Why is that important to you?" The interesting thing is that as Bill pursues this line of questioning, he always seems to get to the same answer. So I'll save us a lot of time by giving you the answer.

HAVING MONEY GIVES YOU CHOICES IN LIFE!

We all want choices. And we don't want somebody else choosing for us.

Money is a finite resource for most of us. There is only so much to go around in all our lifestyles. (That's a lesson that has seemed to escape our children and grandchildren ... until they are paying their own way.) Having a spending and savings plan encourages us to devote our resources into the areas where we are going to get the most value for our money ... getting the most bang for the buck, so to speak.

Whether you're working or on a fixed income, most people follow the same pattern. They pay the bills first and then try to save whatever is left over. Imagine yourself with a dollar bill ... and you tear it apart. Some of it goes to pay your mortgage payment or rent, some goes for taxes, another piece goes for food, another piece for clothing, a bigger piece for car expenses, to include car

payments, gas, insurance, repairs, etc. Finally, at the end of the dollar bill is a little corner left over ... that's the part you save.

If you've ever read a financial self-help book, you'll recall that one of the lessons they teach is to pay yourself first. The first piece you tear off the dollar bill should be yours to keep. That way you don't feel so bad about consuming whatever is left.

Ah, it sounds so easy. But here's the reality. Our bills are not the same every month. And, even worse, our bills are not just monthly. Oh, our mortgage payment and our cable TV bill and our phone bill may be monthly. And so is my gas and electric bill. But certain bills are bi-monthly ... every other month. That would be the waste disposal bill at my house ... the trash men. And that's not such a big bill anyway that it makes much difference to me that it comes in every other month.

But what about your property tax bill? Mine is due ... half in December and half in April. My car insurance is due in June and December. My property insurance is due in July. My earthquake insurance is due in August ... Yeah, that's one of the prices for living in Southern California. I have life insurance and long term care insurance policies that are due in November and December.

And, all along the way, we have medical bills that will vary from month to month. I'll bet my situation sounds pretty much like yours. So where's the problem?

The problem is that some things remain constant in life but a lot of things change. And we need to be prepared either way.

Some of you may recall a very popular book called "Future Shock". It was written by Alvin Toffler. Toffler purported that it was not "change" that bothered us as much as the "speed of change". What we used to know for certain was just not true anymore. And that speed of change was going to get worse in the future ... hence the "future shock". You know when that book was written? 1970? That's over 40 years ago ... and the message is even more appropriate today.

I heard another speaker talking about change a few years ago. And while change is good for all of us, there are times we wish we could have things be more simple. And that's what I want us to get to tonight. The speaker was talking about change that was the most stressful for us. Our news is full of stressful events ... wars, drive by shootings, hurricanes and tornados, etc. And we kind of roll with that because it doesn't have much effect on us personally.

But the speaker summarized change that does affect us. His message was that the most stressful change in our life is that which affects us directly ... and we didn't see it coming.

All of us face events each year that “we didn’t see coming”. Being diagnosed with MS or another disease would certainly be a stressful one. And almost all stressful changes have some sort of financial effect. Your car breaks down ... and you had been expecting it to last another two years. You just did your income taxes and you owe another \$1,000. You have a medical setback ... and now you won’t be able to work either as many hours or as many years. The medical condition alone is stressful ... but it’s going to lead to some financial stress, also.

Twelve Month Budgeting is about facing financial reality ... every day. It’s about taking control of your finances. It’s about alleviating stress because you’re prepared for something that you know is going to happen. I’m a salesman ... perhaps we all are in life ... and I don’t know exactly what my income will be from one month to the next. Oh, I have a rough idea of how I’ll do, but I certainly do not have a fixed income.

Here’s the goal with twelve month budgeting ... it’s to have money in the bank to pay all your bills when they come due. There are three ways to pay your bills:

#1 – pay as you go. You always pay cash and you never have any debts. You pay today’s bills with today’s income. That’s the way our society was as recently as the early 1960s. You may owe on a mortgage or on a car, but generally you saved up to buy something. Credit cards as we know them now did not come out until 1968.

#2 – you’re trying to catch up. You are paying yesterday’s bills with tomorrow’s income. That’s what happens when you go on vacation, have a terrific time, and come back to pay your travel bills with your future paychecks. This is the position the vast majority of our society is in. Missing a paycheck or two would be devastating. I just saw an article that said the average American household saved only \$400 last year and the average American household owes \$8,000 on credit cards.

#3 – you’re ahead of the game. You are paying tomorrow’s bills from yesterday’s income. This is the most comfortable position to be in. And that’s where we want to get you with the concept of twelve month budgeting.

Several years ago my wife won, in a raffle, two first class plane tickets to Hawaii and four nights at the Ritz Carlton on Maui. What a great feeling ... going on a vacation where most of the large expenses had already been paid before you leave home. If we wanted to splurge with a special meal or a helicopter ride, we didn’t feel guilty doing so because we knew we weren’t coming home to a large credit card bill for our airfare and hotel.

Now that was a great way to enjoy a vacation. We were free of financial stress. Well, winning that trip was a once in a lifetime deal, but we’ve been able to create

the same stress-free feeling with vacations ever since. We're going back to Hawaii again this Fall ... on our own money. But I've been setting aside something from every week's income so that I have the airfare and hotel room paid for in advance. Now, I've got to tell you that I've been setting aside money since last June. I'm taking the cost of that vacation and I'm spreading it out over 15 months ... before we ever go.

You see, we've been facing reality. We're willing to reduce our current spending to save for something we really want. That's budgeting. We're going without enjoying every dollar's worth of income today to send some money into the future ... to be enjoyed at a later date.

I'll bet you already do that right now ... without thinking much about it. If you are putting money into a 401(k) plan or a 403(b) plan, you are taking some money out of today's spending pattern and you're sending it ahead for the older person you are going to be someday.

When our daughters were ages 3 and 5, we set up a college fund ... to which we contributed the princely sum of \$30 a month. I'm glad your phones are muted because I'd be able to hear you snickering. "How far is \$30 going to go?" We weren't making much money but that account was sacred. Those monies were not to be used for a new car, for a vacation, or for anything except education. The important thing was that we were taking money from our current spending pattern and saving it for a future need. Through the years, as our incomes grew, we directed more money into the college fund. My goal was to have enough in the fund by the time they went to college that we could take the interest income from the fund and, along with current income, pay for college. That way, when they graduated, we'd still have the pot of money.

Well, things rarely work out as easily as you expect. Our daughters went to out-of-state schools ... one to the University of Pennsylvania and the other to the University of Colorado and then on for a masters degree at the University of Missouri. By the time college was over for them, the "pot" was over for me. There was nothing left in it. But all that saving through the years (we drove some really old cars so we could put money into the college fund) paid off with this good feeling. Even though I fell short of my goal, my daughters walked out of college with no debts ... no student loans. I'll tell you, in the financial 100 yard dash of life ... that's like having your starting blocks on the 30 yard line.

So 12 Month Budgeting is setting money aside today for bills that you know are going to arrive tomorrow ... and the day after. I pay my property taxes every December ... even the half of the taxes that are due in April. But I don't start saving to pay my taxes in November. I start the previous December. And I set aside one-twelfth of the expected property taxes each month. When I get the bill in November to pay it in December, I'll already have the money in the bank. I'm using today's income to pay tomorrow's bill. And it works.

I put the money into a savings account. But this isn't the only money that goes into that account. I put one-twelfth of my auto insurance bill into the account each month. When my auto insurance comes due in June, it will be paid by money I set aside from December through May. I'll have nothing left in that account but I'll set aside the same amount each month from June through November to pay the bill due in December. My goal is to have enough to pay the bill and perhaps a little left over. That way, if my premium goes up, I can handle it.

Question: Wouldn't it feel great to have money in the bank to pay large future bills so that you are never surprised or shocked when the bill arrives. We all have unexpected bills that we have to deal with ... that goes with the territory. But when you know you have a large auto insurance premium due that you haven't saved for ... you start kicking yourself. You know that you should have been setting money aside on a regular basis to pay that bill ... but you didn't. You're ticked off ... at yourself ... and that's stressful. There's nobody else to blame.

Twelve month budgeting starts any time you want it to. There's no magic about waiting until the first of the year. The reason is that all your large bills don't come in at one time.

Here's the objective: To have enough money set aside specifically earmarked to pay each of the predictable large bills you have during a year ... and to have that money one month before the bill is due.

OK, here's the starting point. You need to create a "You Are Here" position. You need to know what bills come in each month ... and the best way to know that is to see what bills came in each month over the last 12 months.

Start with last month. Ideally, you can do this on an Excel spreadsheet on the computer. If not, it would be great to have a large piece of graphpaper but I must confess that I haven't seen graph paper in years.

So let's assume all you have to work with is pencil and paper. Divide your paper into 4 columns. The four columns will have the following headings. The first column will be "Payee". This is either the party you wrote the check to or the service that was provided. For example, you could write either "mortgage" or the name of the financial institution. I think it's easier to just write "mortgage".

The second column heading will be "January". The third column heading will be "February" and the 4th column heading will be "March". When you're through filling this in, you'll be able to see where your money went during those months.

Let's assume that your first entry under the "payee" column is "mortgage or rent payment". Just write mortgage or rent in the left hand column. Under January, February and March, put in the amounts paid in mortgage or rent.

If you're doing this on a computer spreadsheet program, of course you can just have all your monthly columns going out to the right ... January through December.

There is no magic to starting in January but you do need to include the last 12 months.

Now go through your checkbook and start listing who you paid and how much you paid. Forget pennies. You don't have to be that accurate. This is like throwing a hand grenade. You don't have to hit your target in the face. You just have to be reasonably close.

As you are entering the payees down the left hand side of the page, create a few different categories.

One category may be "regular monthly bills". Under than category list the mortgage or rent payment, your monthly telephone bill, your monthly cable bill, etc. If you pay your auto insurance on a monthly basis, enter that here.

The next major category will be "regular bills other than monthly". Let's assume that you pay your car insurance in January and July. You want to put down "car insurance" and then enter the amount of the last car insurance premiums in the January and July columns. One thing about insurance premiums. You are always paying them in advance. You are on a pay as you go basis. Insurance companies did not get to be the size they are by giving you insurance without collecting money for doing so.

What we are looking for here are the large bills that are not paid on a monthly basis.

Twelve Month Budgeting is designed to have you turn the semi-annual bills, such as the January and July auto insurance premiums, into monthly bills. Let's assume your auto insurance is \$ 600 every six months. Those of you with teenage drivers are probably thinking: "What planet did Dick Bell just arrive from?" But this is just for illustration. You need to set aside \$100 each month to pay for auto insurance. And you need to set it aside in advance.

That's facing reality ... every month. And when you save the \$100 a month and earmark it for "car insurance", you can't touch that for anything else. The goal is to have \$600 saved by June so that you have the money when the insurance premium is due in July. Now, notice that I emphasized having the money saved one month before it is due. As long as you do that, you don't care whether the

bill is due on July 1st or July 18th. You have the money either way. You can pay the bill on time and not pay a late fee. Late fees are just a huge gouge in our society.

Now, people ask me, where do I save this money? First of all, it's critical to get it out of your sight. You could get cash and put it in an envelope marked "car insurance". That's the way people did things years ago ... and perhaps many still do.

I prefer to put the money into a savings account. If you have converted all your large bills that are not payable monthly into a more manageable monthly amount, it's easy. Let's assume that amount is \$1,000 a month. And you get paid twice a month at your job. Automatically transfer \$500 from each paycheck into a savings account at your credit union. There ... you never see it so you can't spend it.

In July, when the auto insurance is payable, just transfer \$600 back from your credit union account into your checking account and pay the bill.

Twelve month budgeting is designed for you to have the money saved so that you are not stressed when the bill arrives. It's like paying for that vacation in advance.

In my own situation, I keep the money in one account but I have a separate record of how much is in each "fund" ... I have separate "reserve funds" for property taxes, homeowners and earthquake insurance, other insurance, quarterly income tax estimates, etc.

Once you have the habit of saving up to pay bills you know are coming, you are ahead of the game. It is that same habit that gets you to set aside money each month toward a child's education, to a family vacation, etc.

In all my years of helping people with their financial planning, I have never had anybody say to me: "Rats, I wish I had not saved so much". The key to getting ahead financially is to not spend everything you have to spend each month ... to live beneath your means. That way you have money to save for the future ... trust me, you'll need it.

Twelve month budgeting will not restrict you. It will make you more aware of where your money is going now. You know that you only have a certain number of dollars to maintain your lifestyle each month. This concept will help keep you from being surprised and stressed by a bill that you had not prepared for, even though you knew you should have.

Finally, there are three kinds of people in this country ... those who make things happen, those who let things happen, and those who wonder what happened.

Take charge of your own finances. As the old commercial for Life Cereal went ...
Try it! You'll like it!