PAYCHECK TO PAYCHECK … BREAKING THE CYCLE

Presented by Dick Bell to the National MS Society "Relationships Matter" Audioconference on June 25, 2008

Thank you for joining me this afternoon or evening, depending on where you are. Living paycheck to paycheck is a particularly stressful way to go through life and I'd like to share some tips and thoughts on how to improve your financial situation. The format is that I will speak for about 35 minutes, and then we'll open up the phone lines for any questions that you might have.

We are living in a very challenging economy. Even people who have been doing well in life are concerned that their comfort level is eroding … and certainly any financial cushion they have is not quite as plump and comfortable as it might have been only six months ago.

Living paycheck to paycheck means that the dollars that come in each payday are used to pay current bills. You feel like you are treading water. How can I possibly get ahead, you think!

And living paycheck to paycheck normally does not account for the unexpected bill … the flat tire that needs to be replaced or the hot water heater that finally breaks down. And it certainly does not account for general increases in the cost of living. If you haven't noticed cost increases in everything you buy, then you must not be driving a car and you must be eating out of your freezer.

So what happens when we can't pay our bills as they come due? We use a credit card. We put a burden on the lifestyle we will have in the future. Or, horror of horrors, you go to a payday lending company. There's a debt that you'll pay on again and again … and you'll never pay it off.

So let's talk about a game plan, a strategy for improving your financial condition. One of the professional speakers and authors in the financial advisory world is Bill Bachrach. And Bill always leads off his discussions of finances with anybody with the question: "What's Important About Money to You?" Regardless of the answer, Bill will ask: "Why Is That Important?" And he'll continue along that line of questioning. But he always arrives at the same answer, spoken with different words … and this is it. The importance about money is that it "gives you choices in life".

When you live paycheck to paycheck, the only choice you may be making is which bill you can delay a little longer. You spend time figuring out how to manage your payments, rather than focusing on how you can enjoy what you have.

There is one important first step to breaking the paycheck to paycheck habit. It doesn't require any sacrifice … but it requires a joint agreement. It requires a mutual commitment. As a couple, you have to agree that you don't like the position you are in right now and you will do whatever you have to do to improve it. If only one of you makes the commitment, you're dead in the water. The other will undermine your efforts, either unintentionally or deliberately. You're partners, and in this case you are not looking at each other. You are side by side looking in the same direction with the same goals.

You must both agree that improving your financial situation will take a joint effort. That effort will include reducing spending, going without some things you enjoy today … perhaps even getting a second job or working part-time and directing all the additional income into savings or debt reduction. If you both agree that "it's time for us to take control of our lives", you're on the way. And you will start to make choices, not based upon immediate gratification, but upon reaching a more long range goal.

You both need to support each other's efforts … and share in the successes. You have to be the cheerleaders in your own life. And what will you get out of it? I once heard a speaker say that "nothing tastes as good as how being thin feels". Let me repeat that. REPEAT And if you have had success with a diet, you know exactly what I'm talking about.

I'm going to alter that statement, however, to this: "Nothing you buy today will give you as much pleasure as the feeling you will get with $X in a savings account". REPEAT

Close your eyes and visualize with me how you would feel if you had another $10,000 in savings. Another, you say … how about the first $10,000 in savings? When you have money in the bank, a sense of peace comes over you. You're not terrified that rising gas prices will cause you to go in debt. The unforeseen dental bill for your child may annoy you … but it won't devastate you.

You may have read the book: <u>The Millionaire Next Door</u>. If not, save the $25 and I'll give you a summary of the message. The millionaire next door is not the guy with the big house and two leased cars. It's the painting contractor with his truck in the driveway. It's the guy who is living on less than he earns. And that's the first step to breaking the paycheck to paycheck cycle.

Wait, you say, I'm already spending everything I bring home. What do I do?

You have two choices … you can either make more money … get a better job or get a raise … or you can spend less money. Let's focus on the "spending less money" choice, because that is something you can deal with immediately.

But where do you start? Travel with me to the Mall of America in Minnesota. 4.2 million square feet of space … 400 retail stores … 25 sit-down restaurants, 27 fast-food restaurants … big enough to hold 32 Boeing 747 wide-body jetliners. So I'm sure you'll agree the place is huge!

Let's assume you want to do some shopping and you would like to go to Nordstrom, J. Crew and Eddie Bauer. Now we could wander around and, given enough time, we'd come across all three stores.

But time is like money … there is only a limited amount of it realistically. So we go to one of the many directories they have throughout the mall. And, sure enough, we can locate Nordstrom, J. Crew and Eddie Bauer.   Do we have enough information to make our journey easier and time-efficient?

Nope! The most important location on that directory, once we determine where we want to go … is the "You Are Here" position. Ah, once we know where we are we can map out a strategy for getting where we want to be.

For all of us, the "You Are Here" position is a financial statement. That's a listing of what you own … and what you owe. If you owned a business this would be called a "balance sheet". A financial statement is like a scorecard. By updating your statement, you see how you are doing over any given time period.

I do a quarterly financial statement on an Excel spreadsheet. I have all the categories going down the left hand side, and I hope you have a pen handy because I'll go through the categories with you in a few moments. To the right of the categories, I have columns of calendar quarters. Each quarter I insert a new column B so I always have the most recent figures right next to the categories. Going to the right on the spreadsheet, are all the preceding quarters. I first started doing this in September 1991 and my wife and I periodically review how far we have come in that time period. I use calendar quarters because 401(k) plans usually send out quarterly statements. If I were doing this from scratch, I would want to start with figures as of June 30, 2008.

Now, going down the rows on the spreadsheet, in the left hand column, I enter the categories. Once you set this up, it's easy to update.

My first category is: Cash

Under this my subcategories will include our checking accounts, savings accounts, CD's etc. How much can you get your hands on quickly in an emergency? That's your cash account.

My second category is: Investments

Under this my subcategories will include any investment accounts, listed separately, life insurance cash values, non-retirement plan annuities, etc.
If you have money invested in 529 college plans for children or grandchildren, that would be another subcategory.

By the way, I have a separate column that lists all the account numbers. Most of the time I keep that column hidden but it's a great reference for my wife if something happens to me.

My third category is: Retirement Funds

Under this my subcategories will include a listing of all pension accounts, 401(k) accounts, IRAs, Roth IRAs, Tax Sheltered Annuities

My fourth category is: Real Estate

I don't own any investment real estate but here is where I would enter it. And, of course, I list my house as a subcategory. I value my house, not at the market value, but at its cost plus the cost of any improvements through the years … this would be my basis in the house. So if we do a remodeling project, the cost we paid will show as an increase in the value of my house.

I deliberately do not show what the market value of the house might be at any given point in time. I don't view my house as an investment … it's a place to live.

Then, I list the amount of any mortgages or home equity loans separately as a subcategory under the real estate. Next to the name of the mortgage company, I list the interest rate I am paying. It's important to always know what your interest rates are that you are paying.

I subtract the loans from the cost basis and that shows me the net value of the house on a quarterly basis. It's motivating to see that you are making progress.

My fifth and final category is: Debts

Under this my subcategories will be car loans, for example. I don't list cars as assets … they are depreciating daily so they certainly are not investments. How much do I owe. Multiply your monthly payment by the number of months remaining.

The next subcategory, and that's where we will focus the balance of our time, will be credit card debt. And, I suspect for most people, this is the area that concerns them the most.

So list your debts, one by one.

Did you borrow money from parents or other relatives or friends? That's a subcategory.

And, of course, here's where the credit card information goes.

List each card separately by name. And next to the name list the interest rate you are paying.

Next, list the balance that you owe as of the end of the quarter. And do the same for every credit card.

When you are through with this exercise, you'll see on one page what you own (savings accounts, retirement accounts, house, etc.) and what you owe (mortgage, student loans, credit card debt, etc.) So now you have your "balance sheet" and you should keep it up to date on a quarterly basis.

Now, if you were a business, you'd want to know about your profit and loss statement. We'll call that an "income and outgo" statement.

You need to know where you are spending money currently. Again, you need to create a list of what you have paid for over the past three months. Three months will give you a good idea about your spending patterns. And, one rule. You're going to find that you've made some foolish purchases. But no finger pointing … we all do dumb things and the goal is to do fewer of them in the future … to direct our resources where we want them to go.

So, for April, May and June, list what you spent money on … by category.

1. Monthly Fixed Expenses

Rent, mortgage payment, car payment,

2. Monthly Variable Expenses

Utility bills, cell phone bills, grocery store, haircuts, prescription drug costs, home repairs or maintenance

3. Large Expected Bills paid other than monthly

Property taxes, car insurance

4. Credit card payments – how much was interest

5. Niceties of Life

Meals out, cable TV, personal spending

Go back through your credit cards and categorize all the expenditures. Look at each expense and ask yourself: “Could I have gone without this purchase and used the money better elsewhere?”

Tell story of couple who could not save. $1,500 each in ATM withdrawals.

You’ve heard that “Cash is King”. Here’s why! If you are driving to work today and you get a flat tire, that’s an inconvenience and an annoyance. Let’s assume it will cost you $150 to replace the tire. If you don’t have the $150, your inconvenience has elevated itself to a financial nightmare. If you have the cash, while you don’t like to pay for this unexpected expense, at least you are not emotionally devastated. Cash gives you options. Cash gives you peace of mind. Cash takes away your anxiety.

Now, the long range goal is not to build up $1,000 in cash. It’s to build up 3 months of your living expenses. And then 6 months of living expenses. Again, it’s an issue of cash making anxiety go away. Let’s assume you get downsized or outright fired. How are you going to pay your mortgage payment, utility bills, food bills and other minimal living expenses if you don’t have savings. You’re only out will be to put those expenses on a credit card. Now you’re in a death spiral. You have no income coming in and you have to pay high interest and/or late payment fees on your ongoing bills.

$1,000 in savings will cover most emergencies. Three months worth of living expenses in a savings account will remove anxiety about “what if I lose my job” or “what if we have a large medical bill?”

So, before you start repaying any loans, get $1,000 in savings and ideally, more.

You only have two sources of money to support your lifestyle.

1. Man at work
2. Money at work

Eventually, you won’t be able to work. If you or your spouse has MS, the likelihood of a shortened earning period is even greater. Therefore, it is imperative that you spend less than you currently earn and get to the point where you are investing the difference so that you “earn”interest.

So, determine where your money is going right now. What can you as a couple cut back on with the agreement that the reduction in expenses will be directed into paying off your debts?

If you can't live on less than your current income, you are absolutely doomed. You've created a bad habit that will be your undoing. You simply can't count on tomorrow's income to pay today's bills. Life doesn't work that way. You need to be in a place where you are using yesterday's income to pay tomorrow's bills. Take heart! You're already doing that if you are participating in a 401(k) plan. You're taking something out of current income and you're sending it into the future for the older person you are going to be.

To summarize:

1. Do a "you are here" position of your assets and liabilities and update it every quarter.

2. Analyze your spending for the past three months and determine where you could have spent or saved money more wisely.

3. Take action to do something different.

SPECIFIC SAVINGS IDEAS FOR THOSE WHO ARE WORKING

- Pay yourself first! Save money before you ever see it … join credit union and have 5% taken out of your gross check each pay period … emergency fund
- Contribute to 401(k) plan … get company match … $ you contribute will automatically adjust as you get raises … increase it 1% annually
- Plan and save for big annual expenditures in advance … in effect, converting an annual or semi-annual payment for property taxes, car insurance, homeowners insurance into monthly payments … how will you feel when your auto insurance comes due and you have the money saved.
- Overwithhold on your taxes … declare 0 exemptions (pros and cons of $20 per pay period)
- Don't spend your tax refund … save it.
- Focus on getting rid of credit card debt … keep score monthly
- Do not bounce checks or make late payments
- Direct additional savings to a special goal (college fund)
- Save loose change in a mug …
- Change habit (smoking, Starbucks) and put savings into a mug
- When you pay off a car loan, keep putting same amount into bank account
- Overpay on your mortgage (money is tied up but you reduce your total interest)

- Pay attention to taxes. If you have ongoing medical or childcare bills each year that you pay out of pocket, see if your company offers a cafeteria plan (Section 125 plan)

The big message here is that “Anything Works if You Do!”

SPECIFIC SAVINGS IDEAS FOR THOSE WHO ARE NOT WORKING OR ON A FIXED INCOME

- Save any increase you get in Social Security benefits
- Examine your spending … where can you do something cheaper (cable TV, phone, etc.)
- Buy pizza at supermarket and cook at home vs. Dominos
- Use coupons at grocery stores … also belong to their “clubs” at no cost to get their discounted prices
- Use shopping list to avoid impulse buying
- Try not to spend investment principal but spend the dividends and interest
- If you took a home equity loan to pay your current or past bills, you’re heading for trouble … must change spending habits

FINAL THOUGHT

Keep score. Update your statement of amounts you owe and amounts you have saved monthly or no less frequently than quarterly.

Success will encourage even more success.