Personal Budget Basics

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IDEAL Professional Development Seminar Series

Philosophy

- How “interesting” is this problem?
  - Introspection
  - Life’s constraints
  - Working without a net

Basics (Before the Worksheet)

- Income
  - Do you have a job?
  - Do you need to work multiple jobs?
  - Do you own assets? (Probably not.)
- What to do when you get an offer?
  - Negotiate? (In general, yes)
  - Don’t ask. Make your case.

Income

- National Assoc. of Colleges & Employers: Class of 2014 Starting Salary is $45K
- Payscale: Lafayette College "Early Career" Salary (0-5 years) is $59K

Fixed Costs (Chosen and Unchosen)

- Chosen Fixed Costs (Costs you’ve already built into your life)
  - Student Loans
  - Other Debts
  - Partner’s debt (Most of you will be single)
  - Remittances

Unchosen Fixed Costs

- Housing (rent, furniture, household items)
- Utilities (phone [cell], electricity, heat, cable/landline/internet)
- Food (groceries)
- Clothing
- Transportation
- Insurance (home/renter, life, medical, dental)
- Retirement and savings

Variable Costs

- Food (eating out)
- Pets
- Entertainment (nights out, movies, etc.)
- Gifts
- Vacations

Health Insurance

- Somewhat complicated by Obamacare
- https://www.healthcare.gov/young-adults/children-under-26/
- "If a parent's health insurance plan covers dependents, you usually can be added to their plan and stay on it until you turn 26."
- You can do this even if you turn down an employer's plan.

Health Insurance

- However, some states and plans have different rules, so you must check with their plan.
- Also, if you live in a different place/state than your parents, are there in-network providers available to you?
- You may save money staying on your parents' plan. You may not. You need to look at all of your choices to see which is best.

Why 3 Slides on Health Insurance?

- To let you understand the magnitude of the numbers, a single employee at Lafayette must pay \$580/month for the standard PPO plan. If you want dental coverage, that's an extra \$41/month. That's \$7,452/year.
- You then face an \$800 deductible and varying co-payments (10-15% of cost above the deductible).
- So if you need medical care beyond preventative care, you pay \$8,252 before you get the insurance company to pay for any of it.
- Oh, and Lafayette's plan is pretty good.

A Budget

- Suppose that you have a job in NYC for $50K per year.
- You and two friends are going to rent a place in Williamsburg for $4K per month. Your share is $1,333. It's a bit of a walk but you can get to the Metropolitan Station, so you can geta MetroCard around for $116.50/month.
- You'll rent a car for weekend getaways once per month for about $100/month.

A Budget

- You graduated with $25K in loans with an interest rate of 4%. (About $250/month)
- In NYC, Turbotax tells me that a single person with $1,000 of loan interest and $50K salary owes $5,600 in federal taxes and $3,600 in state taxes.
- You also owe $3,100 in Social Security taxes and $725 in Medicare taxes.
- That’s $13,025 in taxes. (26% of income. Ouch!)

A few more assumption

- You contribute 4% to 401(k) plan for company match.
- You pay an extra $100/month for furniture and other household items.
- Utilities are $250/month but split three ways.
- Food and eating out are $416/month (about $14/day).
- You stick with no car and pay $217 for MTA and car rentals.

More Assumptions

- Clothing is $2,400 per year or $200/month.
- You pay $30/month for renter's insurance and stay on your parent's health plan. Your parents charge you $100/month to pay towards your deductibles and co-pays.
- You go on two $2,000 vacation per year. You spend $100 per weekend on entertainment. That's $7,000/year or $583/month.
- You allocate another $100/month for incidentals (soap, toothpaste, tape, cleaning supplies, etc.)

College Board Budget Guide

- Note that you are $500 in the hole and I've been conservative.
- They said you should budget 34% of your income for taxes but your tax rate is somewhat lower because you only earn $50K/year.
- I was also low-balling several other numbers.
- Note: even if you give up both vacations, you are still in the hole.

What to do?

- It comes back to your fixed costs versus your variable cost. Can you really afford that apartment in Williamsburg where you go out and spend $100/week having a good time?
- I’m not here to judge. I’m just saying that the numbers have to work.

Savings

- You might respond, “Who needs to put 4% of my salary into a 401(k) plan?”
- First, if it’s matched, you’re giving up an immediate 100% return.
- Second, you are at the best time of your life for tax deferred savings.

The 50-year tax deferred savings benefit

- In order to encourage savings the government has created “tax preferenced” accounts.
- The benefits of these accounts grows the further you are from retirement.
- Tax preferenced accounts through employers are called by the name of the tax code section that created them: 401(k), 403(b), and 457.
- Accounts not associated with employers are called individual retirement accounts (IRAs), of which there are two, Traditional and Roth.

Example

- Suppose you are in a 25% tax bracket today and in retirement. You save $1,000 of pre-tax income. You earn 7% per year on that savings. You are 10 or 50 years from retirement.
- If you invested in the same 7% asset, let's assume you'd have to pay 25% of the 7% in taxes each year. (Certificate of Deposit)
- Let's compare the amounts of money you have in retirement when you use a Traditional IRA versus a regular bank account.

Comparison

- 10 yrs IRA: 1,000*(1.07)^10*(1-.25) = 1,475.36
- 10 yrs tax: [1,000*(1-.25)]*(1+(1-.25)*.07)^10 = 1,251.07
- 18% more dollars

Comparison

- 50 yrs IRA: 1000*(1.07)^50*(1-.25) = $22,092.77
- 50 yrs tax: 1000*(1-.25)*(1+.07*(1-.25))^50 = $9.686.49
- That's 128% more money. If you get 100% match from you employer. You will have 356% more money in retirement.
- Lesson: The government subsidizes retirement, but they subsidize retirement a lot more for the young.

Conclusion

- Budgeting is a personal, sometimes emotional difficult, process.
- It’s also an important component of your future success.
- There are “important big things” like health insurance and retirement to consider.
- It’s also important to not lock yourself into fixed costs that you cannot afford.