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


• “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 get a 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.)
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 preferred” accounts.
• The benefits of these accounts grows the further you are from retirement.
• Tax preferred 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: \(1,000 \times (1.07)^{10} \times (1-.25) = 1,475.36\)

• 10 yrs tax: \([1,000 \times (1-.25)] \times (1+(1-.25)\times .07)^{10} = 1,251.07\)

• 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.