How To Budget On An Inconsistent Income

Intro
Welcome Rockstar Nation to the Financial Rockstar show. I'm your host Scott Alan Turner ready to help you get out of debt, save more money, and retire early. In the studio with me is producer Katie, who knows the difference between affect and effect. On the show today we will be answering your questions about money, business, and life. If you have a question you would like answered on the show visit GoAskScott.com

If you missed the last show we heard from J Money of Budgets are Sexy. If you want a sexy budget, be sure to go back and listen to J.

SEGMENT
If you run a business that is seasonal, you're an employee that might have more hours or work in different seasons like a wedding planner, you're a salesperson on commission, it's more of a challenge to achieve financial success on an variable or inconsistent income. Or maybe you're a part time worker and you get different hours week-to-week.

What do you need to do to make sure you've got enough money to get through the better times and the lean times each month?

First you create a spending plan that includes everything you would normally have in a budget. Everything you might spend money on throughout the year organized into categories that make sense to you. Include your debt obligations, blow money, entertainment, car insurance, vacation - everything.

Just like any other person budgeting, when on an inconsistent income, you must calculate the must haves in your life and figure out how much they cost.

And your needs are true needs:

- the rent or mortgage
- electricity
- food
- auto or other transport costs to work – perhaps that is the Internet if you telecommute

Those are all top priorities and have to be paid for first. You can't survive without them. A simple test is if it's something you can survive without, it's not a need. Christmas presents aren't a need, and neither is the family vacation. Eating is and heating the house is.

Then, take everything in the list and put it in priority order starting at one. Food should be number one. You have to eat, right? What's next? Probably your car so you can get to work and make money. Go down through the list until every budget item has a number.

Next write down how much money each budget item costs, or you plan on spending on it. For example your grocery budget might be variable, but your mortgage is fixed. Are you going to spend $500 a month on food or $600? Write that down.

The third step is when you get paid, go down the list and spend the money in the order of your priorities.

If you run out of money before the end of the list, nothing else gets paid, or saved for because the money is used up. If you're running out of money because you went on a weekend getaway, you have a problem. You're priorities are out of whack.

It's ok if you have to miss contributing to your retirement for a few months. Don't feel bad - that's part of having an inconsistent income.

Along with this I want you to have a separate feast and famine fund. You feast when times are good and the money is rolling in. But during the seasons of famine when things aren't so good, it's a good idea to have a backup source of money you can use to cover some of the other items in your budget.

Let's say you're a small business owner and you're budget is $4,000 a month. If you make $5,000 in one month, put that extra into your feast and famine fund. If a month comes along where you only make $3,000, you can use that extra $1,000 from your fund to cover the balance of the budget.

When your irregular income is more than you need to meet expenses, that's a feast. When it is less than needed, you're in a famine. Over the course of a year you can figure out the ups and downs in your income and get an accurate picture of what you need to keep in your feast and famine account. Figure out what the worst case is in a year and take the extra from the feast months and set it aside for the famine months.

Now on to your questions.

QUESTION: Maria and her husband are saving up for their first house. We're trying to figure out our budget and how much house we can afford. What are the extra costs of owning a home might not be aware of?

ANSWER: First time home buyers - how exciting! It's the biggest purchase you will ever make so you should be scared out of your wits.

No, just kidding. When you buy a house you can afford and plan ahead like you are you have nothing to be afraid of. But before you even think about extra expenses, make sure your financial house is in order. If it's not, then you should be scared out of your wits.

- All of your debts paid off. Credit cards, car loan, medical bills, etc. Preferably student loans too, but at least no credit card debt and no car loan. It will just make. life. simpler. And the marriage, better.

- Have a 3-6 month emergency fund saved up in case of a job loss or other unplanned event. If somebody get laid off a week after the closing, you can sit back and say 'ok, we got this.' We've got our emergency fund, we're safe for a while until we get some more work.' Piece of mind - there is no price you can put on that.

- Before you start looking for a house and get new house fever, check your credit s core and make sure it's in good shape. Both of your scores. Those numbers are going to make a big difference in what the interest rate is going to be on your loan. Thousands and thousands of dollars are at stake here, if not tens-of-thousands depending on how long you live in the house. If you're score is a little low you've got some work to do.

If you don't put 20% down - which you should do - the lender is going to require you to pay Private Mortgage Insurance. Mortgage insurance is required for most home loans that don’t have at least a 20% down payment. It’s bought and paid for by the homeowner, but it offers them no coverage. In a nutshell, it’s there to protect the investor if the loan goes into default.

It's a junk fee, plain and simple. It's there as a huge money maker for lenders. And it ain't cheap. It can be 2% of your loan.

Closing costs are another expense. Closing costs will include title insurance, appraisals, attorney fees, loan interest, pro-rated property taxes, junk fees like document processing fees when the admin walks to the printer and presses the copy button and charges you $50 for pressing Print. Closing costs are negotiable between the buyer and seller. Always try to get the seller to pay them all and stick them with the bill. They should be willing to pay at least some of the closing costs. It depends on the market though. If it's a sellers market they might say forget you, you want the house you pay the costs because I've got five other buyers lined up right behind you if you won't. In a buyers market sellers are more willing to be flexible if they want to get out of the house.

What else?

Property taxes - huge. That's an easy one just search online for the county where you want to live and see what percent the property taxes are per year. Or better yet, find a house you like in your price range and you can lookup online what the exact amount is the taxes will be each year.

Utility costs - they will be higher than if you live in an apartment. You'll need new appliances - budget for those unless the seller is leaving them behind. You can negotiate that too if you love their refrigerator. Homeowner's association fees - those can be hundreds of dollars a year.

If you have a yard, you need a lawnmower. Weedeater. Edger. Pruning sheers for the bushes. Plunger for the toilet because you're now the plumber, not the maintenance man you used to be able to call. There are about a hundred things you'll need you never knew you needed. You learn the inside of Home Depot pretty quick.

So make sure you have a home improvement budget.

Knowing about all those extra costs will put your financial house in order first, which will make your new house ready for you to move into much more pleasurable.

Thanks for the question Maria.

QUESTION: Yossi writes in and asks for help on paying off my credit card debt using my current income.

ANSWER: With an existing income in order to get out debt faster you'll need a written plan to succeed at the fastest rate possible. There are three parts that when you do them together will kill your debt the fastest.

1. Having a written spending plan
A written spending plan where you figure out how you're going to spend all of your money each month before you spend it helps you have money at the end of the month instead of more month than money.

2. Going on a cash budget and cutting up your credit cards.
You have to get off the credit cards because you can't get out of debt by taking on more debt. It's been proven we spend more money when we use credit cards. If you want more money, spend cash. It's that simple.

3. Paying off your debts from smallest to largest
By attacking your debts from smallest to biggest it gives you little wins. A little wins lead to big momentum. If you have a $10,000 car loan at 6% interest and a $25,000 in credit card debt at 18% interest mathematically it makes more sense to pay off the credit cards first. Mentally, paying off the car loan first is better because you can get it done faster. Results yield more results. Trying to lose a pound in a week is a lot easier than trying to lose 50 pounds in six months. Because mentally it's easier to grasp and it's a quick win, right? You need that momentum to crush debt, or to save money, or whatever your long term goals are. The only way to reach a long term goal is to break it into smaller, manageable short term goals. Results yield more results.

Good luck Yossi.

TOPIC: Money lessons for pre-schoolers

QUESTION: Laura writes I have a four year old son. He's an only child and I'm a single mom. We don't have much extra each month in the budget. I manage to save up for a few small gifts for his birthday and Christmas. I feel bad when we go to the store and he points at the shelves wanting something. Is there anything I can do to teach him about money?

ANSWER:

- University of Cambridge found kids money habits are formed by age seven.
- Mine, share, My turn.
- Waiting is a hard concept to grasp. But it's the one you have to teach. Let them save up to buy something. Take 1/2 the money turn it into money for chores. My 2-year old know what cleaning up is. They already know how to put stuff away and where to put it. And they know if they spill something on the floor how to wipe it up. Kids are smart - yours are too.
- Show them how to save in an envelope. Let them go to the store and make a purchase with money they earned. Not with money they were given for just being born. That's nothing. That's not a lesson. That's a mooch and a spoiled brat. I was a spoiled brat, I know.
- When kids get older, you can't say 'we don't have the money' and then whip out a credit card. Kids are smart. You can tell them 'we're buying food today for dinner.' End of story.

I want to hear from you
If you have a money-related question you would like answered, please visit GoAskScott.com to get in touch with me. That website has my email address, twitter, and you can also leave me a voicemail. Please contact me, I'm here to help you.

Segment: How to automate your savings with Digit
The average American only saves 5% of their income. This isn't enough for retirement, an emergency fund, or just the occasional big purchase. If you are saving 5% or less, there is a free service which analyzes your checking account, spending patterns, and automatically withdrawals what you can afford to a savings account. It's called Digit. Digit.co is a service that makes small, usually $5-$50 dollar, transfers to your Digit.co saving's every two to three days.

If you haven't been able to save on your own or you don't want to save a large amount once a month, give Digit a try. Other reasons to sign up are for a savings goal, such as an emergency fund, a Christmas gift budget, a vacation fund, or just to get into the habit of saving.

It works by noting your spending habits and the average amounts in your checking account. After doing this analysis, Digit starts transferring acceptable amounts of money into a Digit Savings Account. Digit has a no-overdraft policy so they won't put you into the red. You migh wonder "how is this service free?" Digit doesn't pay interest on your savings so they are able earn interest on members' savings and pay for their business expenses.

Automating your savings is a key wealth builder. If you're having trouble automating your savings give Digit a try.

Now back to your questions nation.

QUESTION: Brad asks how can I get out of debt faster?

ANSWER: The first two components of beating debt are a written spending plan and moving to the cash budget. A written spending plan helps you track where your money is going so you won't wonder where it went. Hand-in-hand with a written spending plan is the cash budget. You can't get out of debt by taking on more debt. And cutting up the credit cards is the only way to keep from taking on more debt. The cash budget is great because you get control of your money and you end up spending less because spending cash hurts. Whipping out a piece of plastic is easy, that's the primary cause of credit card debt. It's too easy to overspend.

Once you figure out where you're money is going you'll be able to direct more of it towards debt. And you want to throw as much money as possible at debt to kill it the fastest. To do that we need more money. Money only comes from two places.

1. Decrease your expenses
Take care of the little things - shopping for groceries smarter, eating out less, sticking to only what you need to buy, not what you want to buy.

Sell everything you don't need. If you haven't used something in six months - do you need it? If not, get rid of it and put the money towards debt.

Take care of the big things - If you have student loans, look at having them consolidated at a lower interest rate. When I tell people this the intent is not to stretch out your payments - it's to get your interest rate lower but keep paying the same amount each month. This way you're putting more towards principal and less in interest.

If you have a car loan, consider selling your car and paying cash for something cheap and reliable. You can always get a nicer car when you're out of debt. Car loans are wealth killers.

Shop your auto insurance and see if you can get a better rate. Shop your cell phone plan. Shop your Internet. Cut the cable. Trim all the fat you can from your spending.

2. Increase your income
While there is a limit on how much you can decrease your expenses by, your income is virtually unlimited. There is no cap.

Now we all have responsibilities and may not be able to pick up extra work or side jobs. But if you have idle hours it's a good option.

On my website there is an article about 100 ways to make extra money.

If you're a rockstar employee - ask for a raise. If you're a rockstar employee - look for another job that will pay you more. The fastest way to increase your income is to change jobs every couple years.

3. Focus
Don't try to save for a house, save for retirement, save for a car, save for a vacation, and pay down debt at the same time.

Pay down your debt, pay down your debt, pay down your debt, and pay down your debt. Do nothing else until your debts are gone. It's a system that works. Just do one thing at a time. When you divide your focus and your finances you accomplish nothing really, really fast. If you have laser like focus when it comes to paying off debt, skip the vacations, skip the dessert, skip the new clothes, that's when change and progress happen. It might take a couple years. But it beats being in debt for ten or twenty years, right?

Thanks for the question Brad. Please keep me up-to-date on your progress getting out of debt.

QUESTION: Jamie writes in and wants help with spending too much.

ANSWER: Going on a cash budget using the envelope system is the quickest and easiest way to stop spending too much. What's the envelope system? Simple - you go to the bank on the last day of the month. You withdraw only as much money as you plan on spending in the upcoming month. That's important - you have to have a spending plan for this to work. Then you spend your cash or use a debit card the entire month.

Why does this work? Because you can only spend what you have available in cash. Using the envelope system makes you a smarter and more thoughtful spender. When you run out of cash, you don't have anything else to spend. Unlike with a credit card where you can go willy-nilly and buy whatever you want. Then you get the big credit card bill 30 days later and wonder why this bill is so big.

If you limit yourself each month to $500 to eat out for example, you quickly learn to watch your spending each day to avoid running out of money. And you'll be shocked but most families spend that much month eating out, they just have no idea because they've never added it up.

If you've never tried to stop using your credit cards and going using cash and debit card only, I challenge you to try it out for 90 days. Using cash instead of credit is the single best way to avoid overspending. Trust me - this system works. It's a game changer. It's a life changer. It's a retirement changer.

Thanks Jamie for the question.

Commercial break

Welcome back, everyone.

QUESTION: Cooper is 32 and has a good paying job. His younger sister just graduated college and wants to get a condo. She just started a new job with a large corporation where she works in the marketing department. She's asked me if I would co-sign on the loan. She's smart and seems to have her act together, but is this a good idea?

ANSWER: If a lender isn't willing to give someone a loan, that person can't afford the loan. It's a big red flag. Red alert. Warning, warning. Does not compute. All hands abandon ship. The only way you would ever say yes is if you had all the funds available to pay off the loan in full. And even then it would still be a bad idea.

When you cosign for a loan you become legally obligated to pay back that money if your sister can't. If she misses a payment those late payments show up on your credit report. And your credit score goes down. She might be the world's greatest sister but you don't know what's going to happen to the company she works for. They may lay off 1/2 the company tomorrow. Then you've got a sister with no income and a mortgage. Which means you have a new condo. Without the benefit of being able to live in it. Or own it. She might get a wild hair in six months and decide corporate life sucks I'm going to go travel the world.

And that's what will likely happen. These things don't work out for the better. Some way some day you're going to be coming up with that condo payment, and you don't want to be that guy. I don't want you to be that guy.

Fresh out of college and wants to buy a condo? No way. Get some roommates and rent an apartment until you can afford your own place. Who are these kids? A couple generations ago parents had to save up for a home. Now kids get out of school and feel they're entitled to have the same sized house as mom and dad and drive the same car. They worked for that stuff to afford it. Put some time in on the clock for four or five years then get a starter home.

No way I'm co-signing for a loan. I wouldn't co-sign a loan for my own kids if they were old enough. Avoid it like the plague. It doesn't mean you don't love your sister. It means you love her enough not to damage the relationship by taking a huge risk on some unforeseen event that would damage the relationship.

Thanks Cooper for the question.

Daily inspiration

According to the American Psychological Association, willpower is a limited resource, and it can be depleted. Many of us think it would be easier to save, spend less, or live healthier if we only had more willpower.

Researchers think that willpower can strengthened but also admit that as a day goes on, the more temptations you turn down, the less likely you will be able to turn down the next temptation.

We get into a mode where we deserve something because our days are hard, or our life has been stressful. What do I mean?

Well let's say you like to sleep in. How many of us like to do that occasionally? And despite loving to sleep in, you got up early Saturday and went for a torture session called a jog. You got home and spent two hours cleaning and doing laundry. Your afternoon is stressful because you had to do some studying for a test Monday. A friend calls with plans for an expensive night out you can’t afford, do you go?

Or maybe this morning you passed on muffins in the office, you also pass on your co-workers birthday cake and instead eat five almonds for your afternoon snack. You run several errands and arrive home starving. Your husband suggests a night out at an Italian restaurant. Do you think you'll feel like sticking to your diet?

If your brain is telling you that you DESERVE to spend money you can't afford to spend or eat what you will regret the next day, take a deep breath and remember that your brain has a hard time seeing into the future.

Think about all that lasagna and pasta for dinner and getting on the scale the next day. Or think about all that debt you have or the empty emergency fund before you go out to that expensive steak house.

Now that you know these things can happen use them to evaluate choices and decisions with the knowledge that your first thought might not be your best thought or good for you in the long run.

Don't let your brain's desire for now get in the way of a great future. Your future self will thank you!

Those are the words.

Outro

Next time we are going to be digging into credit reports - how to check them for free, how often and why it's critical to do so, as well as answering oodles of your questions. Keep them coming!

That's it for this episode. I'm your host Scott Alan Turner. Rockstar Katie is my producer. All the links mentioned in the show are available in the show notes on ScottAlanTurner.com

Today's episode was powered by Ben & Jerry's ice cream.

Thanks for listening!