A Short Guide to Home Budgeting (demo source)

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Chapter 1
Where the Money Goes

Income and Spending

Money arrives as income and leaves as spending. A budget is simply a plan that says, in advance, where each unit of income will go.

Fixed costs are the same every month: rent, loan payments, insurance premiums. Variable costs change with your choices: groceries, fuel, entertainment. Irregular costs arrive a few times a year: a car repair, an annual subscription, a holiday gift.

Irregular costs cause most budget surprises because they are easy to forget. A simple fix is to divide the yearly total by twelve and set that amount aside every month.

Whatever is left after fixed, variable and irregular costs is the surplus. A negative surplus means the plan spends more than it earns.

The Three-Bucket Rule of Thumb

Many people split their after-tax income into three buckets: needs, wants and savings. A common starting point is 50 percent, 30 percent and 20 percent.

Needs are the things you must pay to live and work. Wants are the things you choose. Savings include the emergency fund, retirement, goals and extra debt payments.

This is a rule of thumb, not a law. In an expensive city needs may take more than half of income, and the other buckets shrink. Use the split as a first draft and adjust it to your situation.

Tracking and Reviewing

A budget is a loop with four steps: plan, record, compare, adjust. Plan at the start of the month. Record each purchase soon after it happens. At month end, compare what you spent with the plan. Then adjust the categories for next month.

Zero-based budgeting gives every unit of income a job, so that income minus planned spending equals zero. Savings count as a planned job too.

Reviewing matters more than perfect recording. Look for categories that were wrong two months in a row; those need a new number, not more willpower.

Chapter 2
Safety Nets

The Emergency Fund

An emergency fund is a cash reserve for surprises such as job loss or a medical bill. It is not for planned purchases.

A typical target is three to six months of essential costs. If essential costs are 2,000 a month, three months is 6,000. Starting with one month is better than waiting until you can save the full amount.

Keep the fund in a separate account that you can reach quickly but will not spend by habit. After you use it, refill it before returning to other goals.

Debt Basics

Interest is the price of borrowing. With compound interest, unpaid interest is added to the balance, so next month's interest is charged on a larger amount.

Example: a balance of 1,000 with 2 percent monthly interest adds 20 in the first month. If nothing is paid, the next month's interest is calculated on 1,020.

Two common payoff orders exist. The avalanche method pays the highest interest rate first and saves the most interest. The snowball method pays the smallest balance first and gives quick wins. Choose one and keep to it.

Insurance and Risk Transfer

Insurance moves a rare, large cost to a company in exchange for a regular, small payment called the premium. The deductible is the amount you pay first before the insurer pays.

Insure the risks that would be a disaster, such as health, housing and vehicle liability. Skip cover for risks that would only be an inconvenience, such as a cheap gadget.

Insurance and the emergency fund work together: the fund pays deductibles and small events, and insurance pays the large ones.