Greenway Capital Management

Budgeting Basics

What is a Budget?
A budget is a financial document used to project income and expenses. The budgeting process may be carried out by individuals or by companies to estimate whether the person/company can continue to operate with its projected income and expenses.
A budget may be prepared by using paper and pencil, or on computer using a spreadsheet program like Excel, or some other financial application.
The process for preparing a budget includes:

•Listing of all sources of monthly income

•Listing of all required, fixed expenses, like rent/mortgage, utilities, phone

•Listing of other possible and variable expenses.

Debt-to-income
One of the easiest ways to get a picture of your current financial standing is to calculate your **debt-to-income ratio**. Keeping track of your debt-to-income ratio can help you understand manage your finances. Also, lenders will often use it when considering your credit status.

What is your debt-to-income ratio?
Your debt-to-income ratio compares the amount of your debt (excluding your mortgage or rent payment) to your income. The ratio is best figured on a monthly basis. For example, if your monthly **take-home pay is $2,000** and you pay $400 per month in debt payment for loans and credit cards, your debt-to-income ratio is 20% ($400 divided by $2,000 = .20).

Why is monitoring your debt-to-income ratio important?
Keeping track of your debt-to-income ratio can help you avoid "creeping indebtedness", or the gradual rising of debt. Impulse buying and routine use of credit cards for small, daily purchases can easily result in unmanageable debt. By staying aware of your debt-to-income ratio, you can:

- Make sound decisions about buying on credit and taking out loans.
- See the clear benefits of making more than your minimum credit card payments.
- Avoid major credit problems.

Creditors look at your debt-to-income ratio to determine whether you are creditworthy. Letting your ratio rise above 20 percent may:

- Jeopardize your ability to make major purchases, such as a car or a home.
- Keep you from getting the lowest available interest rates and best credit terms.
- Cause difficulty getting additional credit in case of emergencies.

Debt-to-income ratios are powerful indicators of creditworthiness and financial condition. The bottom line is: Know your ratio and try to keep it low!

How-to calculate debt-to-income ratio.

The first step in calculating debt-to-income ratio is figuring your monthly take-home pay, which is the amount you earn after all deductions. If you're paid every other week, multiply your take-home pay by 26, then divide by 12. This is your monthly take-home pay. If your income is inconsistent, estimate your monthly take-home pay by dividing last year's annual take-home pay by 12.

Remember to include:

- Regular income from alimony and child support.
- Conservative averages of bonuses, commissions, and tips.
- Earnings from dividends and interest.

The second step is figuring your total monthly debt payments. Add your current minimum monthly payments for all credit accounts and loans, excluding mortgage or rent payments. Be sure to include:

- Car payment(s)
- Loan payment(s) (furniture, appliances, etc.)
- Bank/credit union loan(s)
- Student loan payment(s)
- Other loans/credit accounts
- Credit card payments
- Payments for past medical care

Now it's time to calculate your debt-to-income ratio. Divide your total monthly debt payment by your total monthly take-home income from all sources. The result will be your debt-to-income ratio.

Is my debt-to-income ratio acceptable?

Generally speaking, the lower your debt-to-income ratio the better your financial situation. You're doing very good if your debt-to-income ratio is under 30%. Though each situation is different, a ratio of 55% or higher often signals a need to get your spending under control. As your debt payments decrease over time, you will pay less interest. Then you can use your money to save, invest, or spend as you choose.