

# Budgeting for Uncertain Events

A way to add to your wealth

Copyright 2011 Henry K. Hebel

# What are uncertain events?

- These are things that may or may not happen.
- These are things that WILL happen but on an uncertain date.
- These are things that have uncertain costs.
- These are the things that go beyond budgeting for everyday kind of living costs.
- These are the things that can destroy your future.

# Examples of uncertain events:

- Age to die
- Need for extraordinary health care
- Close relative needs money
- Loss of uninsured items
- Replace items that wear out
  - Automobiles
  - Roof replacement
  - Water heater, furnace, washer/dryer
  - Painting inside and out
- Etc.

# Getting protection:

- Health insurance is #1
- Life insurance when young
- Home owner's and automobile insurance
- Savings reserves for things that wear out
- Savings reserves for the unknown
- Plan for graceful coping with less
- Learn to save before spend

# Save before spend!

- If income and savings won't support spending, will have to pay interest on borrowings.
- If save before spend, earn interest instead of paying interest.

# Big Savings if save before buying

- Example: Buy something that costs \$1,000 in inflationary economy:
- REAL interest is actual interest less inflation.
- \$676 growth if invested at 4% REAL interest has future value of \$1,000 if saved for 10 years.
- \$1,000 purchase on credit at 9% REAL interest and paid over 10 years costs \$2,367.
- $\$2,367 - \$676 = \$1,691$  saved by saving in advance instead of buying on credit.
- This is key to building savings and wealth!

# Replacement Budgeting Is Big Help

- Sound home owner associations use **Replacement Budgeting** to reduce needs for assessments. These might cover just the most expensive items like replacing roads and expensive equipment to very detailed lists used by major time-share companies.
- Pre retirees should be building reserves.
- Retirees need replacement reserves to avoid deep cuts in future spending.

# Examples of things that may need replacements:

- Automobiles
- House roofing
- House painting
- Furnace
- Water heater
- Dishwasher
- Refrigerator
- Freezer
- Carpets
- Drapes
- Televisions
- Computers
- Printers
- Software
- Wills
- Power of Attorney



# Planning Alternatives

## for replacement budgeting

- (Good) Do it yourself: Estimate the total costs of replacement items and then keep that separate from your retirement investments.
- (Better) Use the free Replacement Budgeting & Reserves Planner from [www.analyzenow.com](http://www.analyzenow.com).
- (Best) Use a computer planning program that lets you insert the costs of replacing things that wear out, e.g., the Special Events tab on the Pre and Post Retirement Planner from [www.analyzenow.com](http://www.analyzenow.com).

# A good way: Do it yourself:

1	2	3	4	5	6	7
Item #	Item Description	Replacement Today's \$	Useful Life Years	Age Now Years	Annual Budget Col. 3/Col.4	Ideal Reserve Col. 5 x Col. 6
1	<i>Family sedan</i>	<i>\$18,000</i>	<i>6</i>	<i>4</i>	<i>\$3,000</i>	<i>\$12,000</i>

- Column 4 is the estimated years to wear out after purchase . Column 5 is the number of years already in service.
- Enter values in columns 3-5. Calculate 6 & 7. Col. 6 = Col. 3 / Col. 4. Col. 7 = Col. 5 x Col. 6.
- **This gives two results:**
  - The amount you should save this year (Col. 6), and
  - The amount you should already have saved (Col. 7).

# Possible problem!

- But what if you can't carve out the amount in Column 7 from what you have already saved?
- Then you'll have to develop a plan to save more.
- We'll cover this in a minute, but let's first look at a better and easier way to calculate the reserves you'll need.

# A better way: Free Replacement Budgeting & Reserves

from [www.analyzenow.com](http://www.analyzenow.com)

1	2	3	4	5	6	7
Item #	Item Description	Replacement Today's \$	Useful Life Years	Age Now Years	Annual Budget Col. 3/Col.4	Ideal Reserve Col. 5 x Col. 6
1	Family sedan	\$18,000	6	4	\$3,000	\$12,000
2	Pickup truck	\$25,000	8	2	\$3,125	\$6,250
3	Roof	\$10,000	20	5	\$500	\$2,500
4	Furnace	\$2,000	15	5	\$133	\$667
5	Water heater	\$500	12	5	\$42	\$208
6	Carpet	\$5,000	10	5	\$500	\$2,500
7	Exterior paint	\$2,000	8	5	\$250	\$1,250
8	Interior paint	\$4,000	8	5	\$500	\$2,500
9	Drapes	\$1,000	15	5	\$67	\$333
10	Computer	\$2,000	3	1	\$667	\$667
11	Large screen TV	\$4,000	10	1	\$400	\$400
12						
13						
14						
15						
16						
17						
17						
Totals>					\$9,183	\$29,275

# This still doesn't answer problem of insufficient savings to date.

- If using either of the two previous methods, you'll have to calculate the additional savings to build reserves faster.
- One way to get a rough estimate of the additional annual savings is to divide the shortfall in reserves by some reasonable number of years to get there.
- But the truly simple way is to use the Pre and Post Retirement Planner from [www.analyzenow.com](http://www.analyzenow.com).

# Pre and Post Retirement Planner from [www.analyzenow.com](http://www.analyzenow.com)

- Works either for those who are **still working** and need to know how much they should be savings each year, or
- Works for those who have **already retired** and need to know who much they can spend each year, or
- Works for those who plan to still **work some in retirement** to know how much they can spend each year.

# Pre and Post Retirement Planner tabs:

- Income tab
- Investments & Debts tab
- Real Estate tab
- Special Events tab
  - Use this tab to enter things that need replacing.
  - Use this tab to postulate uncertain possibilities to see how they affect your plans. The program lets you compare two alternative cases side-by-side.
- Returns & Inflation tab
- Results tab (Graphics comparing alternatives.)

# Special Event Tab

Your Age	Describe event	Case 1 Costs		Case 2 Costs	
		Growth %	Amount	Growth %	Amount
25		0.0%	0	0.0%	0
26		0.0%	0	0.0%	0
27		0.0%	0	0.0%	0
28		0.0%	0	0.0%	0
29		0.0%	0	0.0%	0
30		0.0%	0	0.0%	0
<p><b>Entries continue through age 100.</b></p> <p><b>Growth % are projected annual increases.</b></p> <p><b>Entries are subtracted from investments in the age entered.</b></p>					



# Even the most precise method won't make an accurate projection!

- Cannot tell when death will occur.
- Can't predict health costs.
- Wear-out times uncertain.
- Future inflation, returns and taxes are guesses.
- Often many financial ways to respond.
- **BUT:**
  - No reserve is guaranteed disaster.
  - Too much in reserve will help heirs.

# Reserve Investments

- Reserves that may be needed within next 10 years should be in liquid accounts like money markets, bank savings or even Savings Bonds. Can't cash Savings Bonds in first year though.
- Reserves do not necessarily have to be separate accounts for use only as reserves.
- Reserves should not be in qualified accounts such as an IRA or 401(k) because need tax and penalty free access.

# Conclusions

- Important to build savings reserve.
- Reserves should not be in qualified accounts or equities (stocks and real estate) because need liquidity and tax and penalty free access.
- Either subtract reserve amounts from investments when calculating how much you can spend each year in retirement.
- Or, it's better to use the Special Event tab in the Pre and Post Retirement Planner from [www.analyzenow.com](http://www.analyzenow.com).