How to recover when your finances are out of control

Money is one of the most complex facets of modern life, yet it is unavoidable and guides many decisions. Though some people come into adulthood with finance skills learned from family members or schooling, many do not and must learn the hard way. Maybe you are in a bad financial spot with a low income and excessive debt. Many people have been in your situation and turned their finances around.

I love helping others obtain a financial skill set. I'm especially passionate about helping African Americans with finance planning to find opportunities that overcome intergenerational wealth disadvantages. Let's work together to gain control of your finances.

Part 1: Understand your starting point

The first step toward setting up a system and making improvements is to lay out a clear picture of where you stand right now.

To start with, open up a Google Sheet, a Microsoft Excel doc, or pick up a notebook or a sheet of paper so that you can have a place to record all of your info.

1. Calculating your net worth

Your net worth represents the total value of all of your assets and liabilities. This means adding up all the money you have in your checking and savings account, plus large items such as a car that you have fully paid off or a home. Then, you must subtract any debt you have. To calculate it the formula is:

> **Assets** *(includes checking, savings, retirement, real estate, and auto)* **– Liabilities** *(includes personal, student, mortgage, credit card, or car debt)* **= Net worth**

The final number may be a positive number or a negative number, depending on your debt situation. This step is not here to discourage you, but rather to give you a number to watch over time, as the goal is to increase your net worth by paying off debts and improving savings and investments—all of which we will cover in this article. Take note of this number and write it down, you can check and re-measure it each year to see how you are progressing.

2. Get a clear picture of your month-to-month spending

This is where you will begin to understand what you get paid, what you spend, and where you can save or change your habits.

I. Calculate your monthly income

Whether you get paid monthly, weekly, bi-weekly, or irregularly, you need to begin by adding up your typical monthly income from your paychecks. If you know this number by heart, write it down on your sheet. If you don't, check your bank account to add up the deposits from the last 30-days, or look at your paystubs and add up the last month.

II. Categorize your spending and identify fixed costs

Make a list of all of your expenses from the last three months to get an average understanding of your spending. Print out your bank statements for the last three months and go through \to put each line item into a category. Get as detailed as possible with categories like:

- Rent or mortgage payments

- Home repairs
- Car insurance
- Car payment
- Health insurance & healthcare
- Groceries
- Home goods
- Haircuts & beauty
- Childcare
- Subscriptions
- Phone, internet, utility bills, etc.
- Miscellaneous optional spending (random purchases that you could live without)

Once you have categorized everything, come up with the total you spent in each category for each month to get a ballpark understanding.

III. Determine how your expenses compare to your income

So far, does it look like you are spending more than you make, breaking even, or coming out with some extra money?

3. Understand your debt situation

Most Americans are in some sort of debt, and despite many misconceptions, not all debt is bad. For example, having a mortgage is considered a smart debt to have, because it is toward an asset that is valuable. On the other hand, credit card debt is not a good debt to have. Don't feel ashamed if you are in credit card debt, but aim to pay it off because it will negatively impact your credit score and will also grow rapidly with interest rates often around 25%.

List the debts you have

Make a list of each debt (including student, credit card, auto, home, etc.) by annotating:

- The full amount owed
- The interest rate associate with each debt
- The amount/frequency of any payments you are making
- Your projected payoff date for each loan

If you don't know these numbers off the top of your head, you will be able to find them by logging into your online account with a given lender or credit card. List these debts in order from highest to lowest interest rate. Your priority will be to pay off the highest rate debts most aggressively.

Part 2: Starting budgeting

Now that you have a sense of your monthly spending and earning it is time to start planning in the form of a budget to ensure you do not spend more than you make.

1. Input your fixed costs

Starting in a new sheet of paper or new sheet in your computer spreadsheet, look at your data from your fixed costs above and add a line item for your total monthly:

- Rent/mortgage payments
- Healthcare & health insurance
- Auto (car payment, car insurance, repairs, gas)
- Bills (electric, oil, internet, cable, phone)

These are all costs that you can't control or reduce because they are set by the provider, and you need each of these services to live and function every day.

2. Input your other living costs

Now you will add lines for the remaining essential costs, but for the items that may change week to week or depending on your habits. This area is not for items like 'new shoes' but instead, create a line for items like:

- Groceries & food
- Home items like shampoo & paper towels
- Beauty and care, such as haircuts
- Subscriptions you pay monthly for services like Netflix, Spotify, or Amazon.

This area should represent items that you can't fully eliminate, but if you needed to, you could find ways to reduce. For example, you could pause any subscriptions you don't use, find places to buy more affordable products, or shop in bulk to save on groceries, etc.

3. Identify your average fun spending

If you spent money on fun items, that is ok as long as you can afford it. Make a note of what this number was and if you need to cut costs, you can look to this section first.

4. Account for your debt payments

If you are currently paying off your debts, add a line for each of those items. If you are not yet repaying your debts, refer to the monthly repayment suggestion for each loan/debt and input that line so that you can start to make progress toward repayment.

- **Tip**: When it comes to credit cards, ensure that you are only using your credit card for items you can pay off within the month. Designate credit card use to one category, like groceries. Set up automatic payments from your bank account so that you can be sure you won't miss a statement payment.

5. How much money do you have left-over?

Subtract the current total from your monthly income to determine how much you have left-over. From here, you will find ways to begin saving and investing with any remaining money.

6. If you do not have any money left-over

Then it is time to find ways to cut costs or bring in extra income. To cut costs, reflect on where your expenses seem too high or where you are spending unnecessarily. Where can you find a more budget-friendly items? Are you paying for too many subscriptions? Should you trade your car in for a cheaper or more reliable model?

Or, to bring in more income you can consider asking for a raise, negotiating a higher salary, finding a side-hustle, or taking up some additional part-time work to give yourself some financial flexibility as you recover from your current situation.

Part 3: Building wealth by saving & investing

In order to increase your net worth over time, you will need to save and invest a portion of your income. It is suggested that you should aim to put aside 10%-20% of your take-home income towards an emergency fund, sinking fund, and retirement savings fund. If you aren't at the point yet where you can do this amount yet, don't worry, but save what you can.

1. Building an emergency fund

Work towards building an emergency fund that covers three to six months of your fixed expenses as outlined in your budget. This gives you a cushion in case of a recession, a layoff, or an unforeseen emergency. If you have money left-over after your fixed costs each month, start by putting one third of that amount into a savings account dedicated to an emergency fund.

- **Tip 1:** Making a separate savings account for this money that you don't touch it for any other reason.
- **Tip 2:** Set up an automatic transfer from your checking account to this emergency fund account each month for a designated amount so you don't have to think about it.

2. Building a sinking fund

A sinking fund helps you save up for a big, planned purchase like a home repair, a vacation, or a wedding. You can take another third of your left-over money and open a second savings account for this fund, so the money stays separate. Just like with your emergency fund, set up an automatic transfer to move money into this account each month.

3. Start investing for retirement

Most of us don't want to work until the day we die. That is why there are types of accounts that you can use to save money for retirement. These accounts are typically investment accounts, which means the money is being put into the stock market, bonds, or other investments so that it is growing on its own with no effort, building on itself through compound interest.

The beauty of investing is that it is called passive income, which means it makes more money without you having to work.

Set aside the final third of your extra money for retirement. Here are two main types of retirement investment accounts that you should consider opening:

- **401K**: This type of account is typically offered by a full-time employer and the will automatically take a portion of your paycheck and put it into this account, and often match that amount giving you additional free money. Ask your employer if they offer this and enroll if you haven't already.
- **Roth IRA**: This is an investment account that you can set up for yourself on an online bank like Betterment. Its great if you don't have access to a 401K. You can contribute up to $6,500 per year towards your retirement. Set up an automatic monthly transfer from your checking account so you don't forget to make contributions.

The new year has arrived, and it's the perfect time to gain control over your personal finances. Start following these steps today and put yourself on the road to financial security.