HOW IT'S DONE

Financial Rules of Thumb

The basic cash flow model is called the 10-20-70 formula. The formula suggests that you save 10% of income (guarantees); limit debt to 20% (excluding home mortgage); and allocate 70% of income to living expenses, (including home mortgage and taxes). This is a starting point for a conversation about financial rules of thumb. Keep in mind that rules of thumb are widely used principles with broad application, but they are not totally accurate or reliable in every situation. Here are a few basic rules of thumb to help you with the conversation about money:

1. John D Rockefeller's rule was to save ten percent and give away ten percent.
2. Bankers recommend that you allocate no more that 20% of net income to debt reduction (excluding home mortgage). The home mortgage should not exceed 3 times income. The monthly payment should not exceed 28%.
3. Total debt service including home mortgage should not exceed 36% of gross monthly income
4. Car loan payments should be under 10% of income and for no more than 4 years. Total transportation expenses should be under 15% of income.
5. Insure your life for 10 to 25 times your income depending on your age and obligations. For more information go to: https://www.lifehappens.org/life-insurance/
6. Have at least 70-80%[1] of your income covered by disability insurance. For more information go to: https://www.lifehappens.org/disability-insurance/
7. Purchase long-term care insurance with a daily benefit equal to the average daily rate in your community and a benefit period of at least three years. For more information go to: https://www.lifehappens.org/long-term-care-insurance/
8. Insure your property for 100% of replacement value. Collision deductibles should equal one week's take home pay. As you build you cash reserves, increase your other deductibles to $1,000 or more.
9. 401 (k) contributions should be at a level that maximizes any employer contributions. If you employer has a policy to match of 50% of your contributions up to 6%, then contribute 6% of your income to take full advantage of the match. If no matching program is available, contribute at least 5% to your retirement plans.
10. Saving for College. The sooner the better. One thought is to save $50 per month per child and then double the amount when the first one starts college. You may not have enough to cover the entire cost, but you will minimize school loans and the amount of time it takes to pay them off. For more information on saving for college, go to http://www.savingforcollege.com/.
11. Net worth[2] should equal ten percent of your age times your income (e.g. Age 45; 100,000 income = $450,000 net worth) – Thomas Stanley, author of ***The Millionaire Next Door***
12. Save from your income and invest from your savings.

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[1] With a "Catastrophic" rider you can replace 100% of earned income. For example if you earn $100,000 and have a group disability plan that pays 60% of your income, you would receive a taxable monthly benefit of $5,000 when disabled. Additionally, you can purchase approximately $1,400 of individual tax free disability income which brings your total coverage to 77%. With some insurance carriers, you can also add a catastrophic rider which would bring your total coverage up to 100% replacement.

[2] The formula is used to define an "Average Accumulator of Wealth (AAW).

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