

Budgeting for a Year with Lumpy Income

U.S.
Financial
Diaries

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Sandra Young, 52, is an African American woman living in Brooklyn with her grown children: Tyler, 25, and Kayla, 24. Sandra manages several branches of a tax preparation agency, which means that she earns most of her income during the six months between November and April. She receives more than 50% of her annual income in the months of February, March, and April alone. She carefully plans out her spending to stretch this income across the full year, scrupulously avoiding all debt. Sandra describes herself as being “fanatical about budgeting.” She grew up in a military family, and learned her finance skills while serving in the armed forces herself. It’s tempting to assume that this is why Sandra is so disciplined. But, Sandra says, she learned these skills the hard way: by going through bankruptcy earlier in her life.

Her daily review of her budget is critical to her financial management system. Two other aspects of her financial life also make it easier for her to live with such an unusual income pattern. First, she qualifies for Veterans Affairs (VA) medical benefits, so she has minimal out-of-pocket insurance or medical expenses. Second, she has been a member of an affordable housing cop for more than a decade so her housing expenses for her three-bedroom, two-bathroom apartment are well below average for New York City.

During the tax season, Sandra works hard, often putting in more than 60 hours a week, managing staff in several locations. She also does other freelance and part-time bookkeeping work during these months. While she continues this part-time work throughout the year, it is always less than full time. In the past, Sandra has worked a more traditional, year-round schedule,

but she did not care for the typical work-a-day routine. She has a positive relationship with her regional manager, who gives her a great deal of latitude to run her area the way she wants. Even though she feels she could get a job that would pay consistently throughout the year and not require such stringent budgeting, she prefers to work hard for part of the year and to have a flexible and more laid-back schedule for the rest.

Sandra manages her budget on an Excel spreadsheet. She has a tab for each year during which she has tracked her finances. She separately tracks each of her financial accounts—which include checking and savings accounts at a credit union as well as an IRA—and the money that comes and goes through those accounts. She creates her budget at the beginning of each year, taking into account each possible category of spending as well as her different income streams. She then monitors her performance against her budget daily, modifying her spending behavior according to how things are going as the year progresses. During the summer, if she sees that she has enough money, she may spend more on a vacation or home improvements. On the other hand, if she sees that money is tight, she spends less.

Sandra has completed some college, though she has not earned a degree. During her service in the Air Force she was stationed overseas, where she received vocational training in accounting. Though she does receive medical benefits, she did not serve long enough to qualify for a military pension. While Sandra provides her children a place to live, Tyler and Kayla do not contribute toward Sandra’s rent or utilities. Other than housing, the children are responsible for their own

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expenses, including food. Kayla attends vocational school part-time and works part-time at a medical office. Tyler works part-time in a retail store and attended community college until recently, when financial aid issues forced him to stop. Tyler would have needed loans to continue. Sandra argued forcefully against taking on debt, even for education. She has told her children that if they do take on student debt, she will not help them repay it.

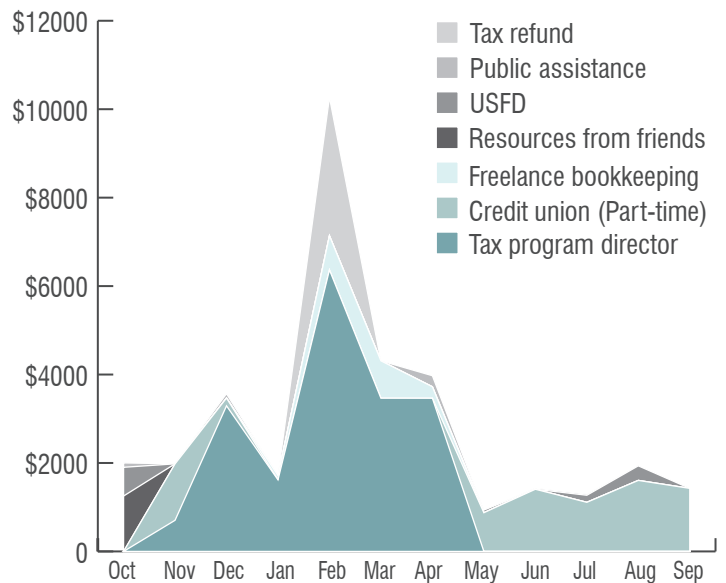
Sandra rates her financial situation as “only fair.” When money is tight, she has to make decisions about which bills to pay based on which services will be turned off for non-payment. She has \$3,000 in savings for emergencies, though she feels she needs \$5,000. She expresses optimism about her ability to get ahead in five years, but she is concerned about having enough in retirement. She perceives herself as employable if she wanted to earn more today in order to save for retirement. She has considered seeking a year-round, full-time job, but she does not think it is worth it to give up the busy then relaxed rhythm of work throughout the year. She prefers to keep a tight budget, and manage her expenses to live within her means.

Income Statement

Sandra is paid \$26 per hour for her tax preparation job, and she earned \$19,000 between November 2012 and April 2013.¹ More than \$13,000 of her earnings from that job came in the months of February, March and April. She earned an additional \$1,975 during the same part of the year through self-employment income for her freelance bookkeeping work. Adding to the lumpiness of her annual income, Sandra also received a tax refund of \$3,135 in February 2013. In total, 53% of Sandra’s annual income (from October 2012 through September 2013) arrived in the months of February, March and April, and 29% arrived in February alone.

In the months outside of tax season, Sandra earned \$8,000 from part-time work as a freelance bookkeeper and at a credit union. In August 2012, a friend of Sandra’s passed away; her friend’s daughter and family moved into the apartment in September and stayed until November. They were able to pass on \$1,200 of public assistance funds to Sandra, which she received in October 2012, to help pay for expenses (primarily food) during that time. Money often gets tight for Sandra between October and

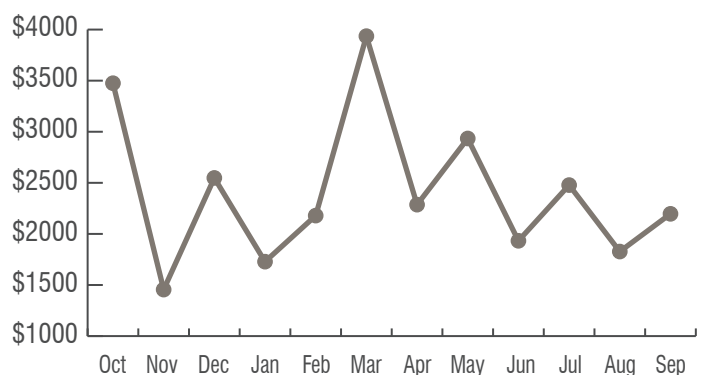
FIGURE 1: Sandra Earns Half Her Income During Just a Few Months



November, just before her full-time work ramps back up. To manage, she spends less, and, as she describes it, her boyfriend pays more often when they go out.

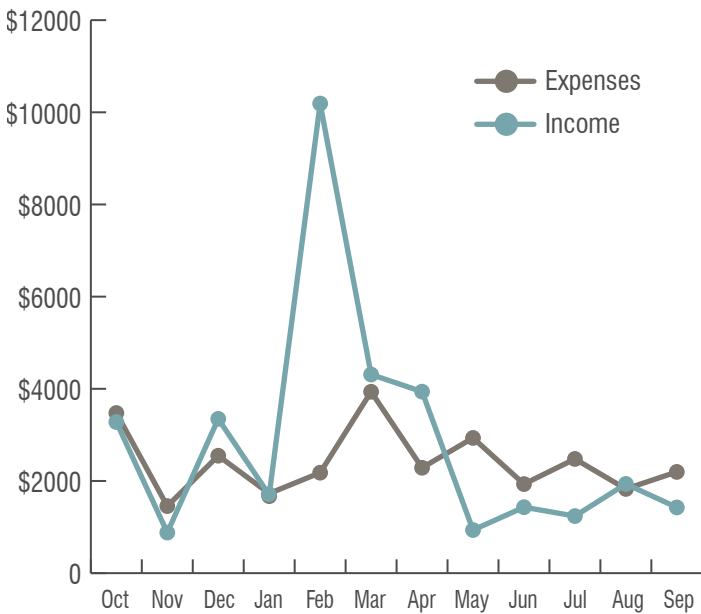
Sandra’s monthly expenses average around \$2,400 per month. Her largest monthly expense is a \$1,115 combined rent, maintenance, and utility (electric, water, and gas) fee paid to the co-op. She generally spends between \$200-250 per month for her cell phone. Around \$160 goes to her bundled communications (phone, cable and internet) bill each month, though Sandra occasionally pays two months at once. On average, Sandra spends around \$130 per month on groceries and \$85 per month on food (e.g. delivery or meals out). Sandra is a vegetarian: she says her food

FIGURE 2: Sandra’s Expenses



doesn't cost much. Her boyfriend occasionally takes her out to dinner. Miscellaneous purchases such as housekeeping supplies, dry cleaning, and personal care products add up to about \$80 each month and Sandra spends around \$50 monthly on public transit and cabs.

FIGURE 3: Sandra Budgets So Her Income Lasts the Year



Between October 2012 and September 2013, Sandra provided \$1,400 in resources to friends and to her children; she distributed most of the money outside of her peak earning months.² She shares resources with friends more often when she is earning less in part because she focuses on saving during the months when she is making the most. Sandra does not generally lean on others to get through difficult times, but she does help friends when they need her. She also gives or receives resources to maximize the value received for both parties. For example, she has a friend on her family plan for cellphone service, because the friend does not have a good credit history and would not be able to qualify for service on her own. In exchange, the friend buys Sandra groceries.

■ Balance Sheet

Sandra's primary asset is her co-op apartment. It is a very valuable asset in a city with such high housing costs, but it is limited. While she can remain in the apartment indefinitely and even pass it on to her children, her shares do not accumulate value and she

cannot sell them on the open market. If she wanted to sell, she would likely receive less than \$30,000 from the co-op for her shares.³ Sandra also has an IRA. She uses it to save her tax refund, but prior to the study she had an emergency that forced her to withdraw much of those funds and pay the 10% penalty. More recently she has decided to prioritize saving for retirement and has brought her balance back up to \$5,000.

When Sandra was younger, she accumulated substantial credit card debt. In hindsight, she is amazed that anyone sent her a pre-qualified offer for a credit limit of \$11,000. She opened several credit accounts and spent freely, not worrying about the debt burden because the minimum payments were manageable. As her debt balance grew, she eventually could not afford the minimum payments. Collection agencies started calling her. She decided to get a lawyer and file for bankruptcy. Sandra felt completely alone as she suffered through the bankruptcy process. She did not tell her family about it, because her father had always emphasized the importance of staying out of debt. The experience was so traumatic that Sandra has completely forsworn debt—to the point of discouraging her son from taking loans for college.

■ Net Income Over Time

The sections that follow provide additional detail on Sandra's cash flow activity. It is important to note that the household data collected as part of the U.S. Financial Diaries Study is self-reported and thus subject to error and omissions. It is likely that some periods of time are more fully reported than others. Because income generally represents fewer cash flows than expenses, income is more likely to be fully reported than expenses. Expenses likely do not reflect the true extent of the household's spending. The weekly sums do not reflect actual account balances, but rather the net of the household's reported income and expenses in each week and month.

The detailed review of Sandra Young's cash flows gives a sense of her finances from week to week. We tracked Sandra's cash flows for more than a year. Here, we highlight three months: December 2012, when tax-season earnings began; February 2013, when she was flush with income from multiple sources; and May 2013, when she had almost no income.

December 2012

In December 2012, Sandra's tax-season income earnings began to arrive, and she used the money to pay for day-to-day expenses.

FIGURE 4: December Overview

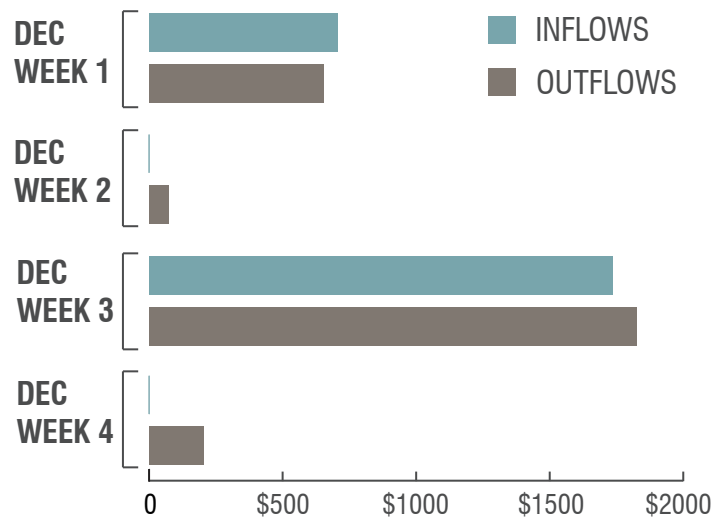


TABLE 1: December Cash Flow Ledger

WEEK	INFLOWS	OUTFLOWS	WEEKLY SUM	ACCUMULATION
DEC 1	+ \$704 in salary	- \$177 on bundled comms - \$160 for friends/family - \$122 on groceries - \$76 on house supplies - \$61 on meals out - \$29 on public transportation - \$28 on miscellaneous items	+\$51	+\$51
DEC 2	+ \$0 in salary	- \$65 on groceries - \$7 on meals out	-\$72	-\$21
DEC 3	+ \$1636 in salary + \$100 from USFD	- \$1116 on rent - \$250 on cell phone bill - \$218 on electronics - \$127 on groceries & alcohol - \$55 on miscellaneous items - \$50 for friends/family - \$10 on meals out	-\$90	-\$111
DEC 4	+ \$0 in salary	- \$150 for friends/family - \$49 on groceries - \$3 on miscellaneous items	-\$202	-\$313

February 2013

In February 2013, Sandra earned nearly a third (29%) of her annual earnings, between income from her main tax assistance job, her freelance bookkeeping work, and her tax refund.

FIGURE 4: February Overview

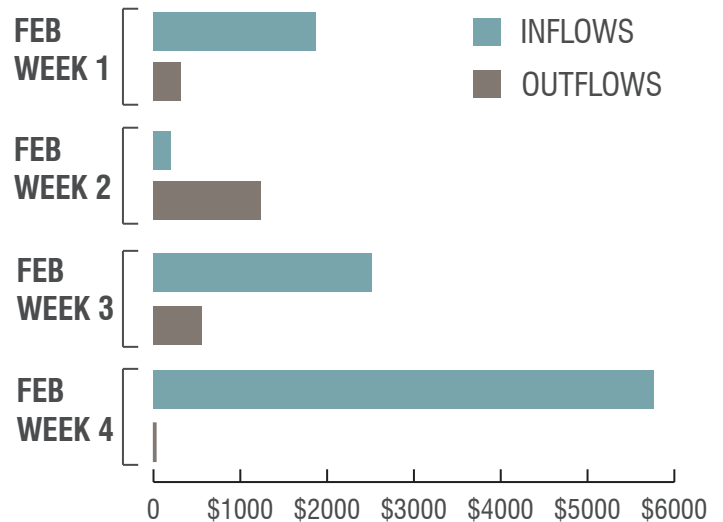


TABLE 2: February Cash Flow Ledger

WEEK	INFLOWS	OUTFLOWS	WEEKLY SUM	ACCUMULATION
FEB 1	<ul style="list-style-type: none"> +\$1766 in salary +\$100 in self-employment income 	<ul style="list-style-type: none"> -\$228 on groceries -\$41 on personal care items -\$29 on public transit -\$12 on meals out -\$11 on miscellaneous items 	+\$1545	+\$1545
FEB 2	<ul style="list-style-type: none"> +\$200 in self-employment income 	<ul style="list-style-type: none"> -\$1116 on rent -\$100 on groceries -\$20 on public transit -\$5 on meals out 	-\$1041	+\$504
FEB 3	<ul style="list-style-type: none"> +\$2300 in salary +\$220 in self-employment income 	<ul style="list-style-type: none"> -\$324 on cable/satellite TV -\$215 on cell phone bill -\$21 on meals out 	+\$1960	+\$2464
FEB 4	<ul style="list-style-type: none"> +\$2300 in salary +\$3135 from tax refund +\$331 in self-employment income 	<ul style="list-style-type: none"> -\$28 on personal care items 	+\$5738	+\$8202

■ May 2013

A month after her tax season earnings ceased, Sandra's income was minimal; her expenses included some vacation-related spending.

FIGURE 6: May Overview

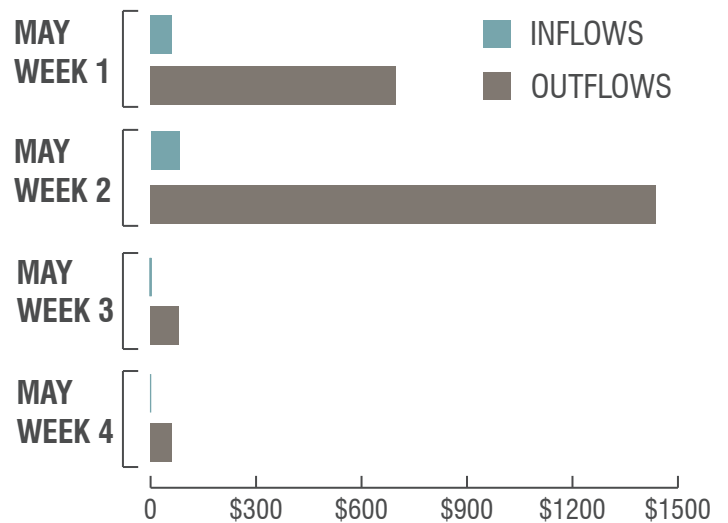


TABLE 3: May Cash Flow Ledger

WEEK	INFLOWS	OUTFLOWS	WEEKLY SUM	ACCUMULATION
MAY 1	+\$60 in resources from a friend	<ul style="list-style-type: none"> - \$524 on trips/vacation - \$90 on gifts - \$68 on miscellaneous items - \$42 on meals out - \$35 on taxis 	-\$699	-\$699
MAY 2	+\$82 from part-time job	<ul style="list-style-type: none"> - \$1116 on rent - \$110 on trips/vacation - \$80 on miscellaneous items - \$60 on meals out - \$40 on electricity - \$20 on taxis - \$12 on groceries 	-\$1356	-\$2055
MAY 3	+\$0	<ul style="list-style-type: none"> - \$50 on groceries - \$20 on public transportation - \$10 on dry cleaning 	-\$80	-\$2135
MAY 4	+\$0	<ul style="list-style-type: none"> - \$40 on public transportation - \$10 on meals out - \$10 on miscellaneous items 	-\$60	-\$2195

■ Conclusion

Sandra has chosen an unusual structure for her financial life, and the seasonal nature of her income means that she has to budget over a longer time period than many households. Her income arrangement does not result from a lack of options: she has the qualifications and capability to secure a job with a more consistent, year-round stream of income, but she likes her flexible work schedule. Despite the irregularity of her income over the course of a year, Sandra's financial life is stable, and she retains a remarkable level of confidence and control over her finances. This level of control is thanks largely to her straightforward and highly disciplined system of budgeting and financial management.

Sandra is unusual in her financial rigor, but we can learn from the system she has devised. Like Sandra, other households facing peaks and valleys of income need tools that enable planning and disciplined spending. Alternatively (or additionally), they can benefit from financial products that better align their spending with the timing of income. Sandra's experience shows how important control and transparency are in organizing the pieces.

Sandra's experience shows that "everyone has a system." But her story also helps us see the corollary that not everyone should have the same system. For Sandra, avoiding debt entirely is a valuable approach. She has no need for consumer credit, and prefers to avoid any risk of overspending. However, applying that same advice to her son, who has a different use for the funds he would like to borrow and is at a different stage of life, may not be appropriate. Taking on debt to invest in higher education could be a good choice for him.

Today, Sandra's financial life is solid and predictable. Her prospects for retirement in 15 years are cloudier. Sandra wonders whether she will be able to retire as comfortably as she lives today. Her access to VA healthcare provides a financial cushion, protecting her from unpredictable spikes in healthcare expenses. Her apartment at the co-op in a nice part of Brooklyn is another key component of her financial stability. Still, her current income is insufficient to allow retirement savings at a level that would enable Sandra to maintain her present standard of living. Her choice to

maintain her current job and income level privileges her mid-term future over her long-term future. Sandra's choices in this regard differ from the typical pattern of households that struggle against the temptation of present consumption to save for the future. Sandra is in fact a disciplined saver and actively limits her day-to-day consumption to save for the near-term, mid-term, and long-term future. But even this discipline doesn't translate into changing her lifestyle to build up long-term savings. In that way, Sandra illustrates the depth of the retirement savings challenge: behavioral science and nudges to encourage saving for the future over spending for the present are invaluable, but may not be nearly enough to enable Americans to generate a secure retirement.

Notes:

1. Net of withholdings; her gross income for the tax assistance job was \$23,000.
2. The USFD survey distinguishes between transfers that are designated as loans, in-kind transfers (e.g. childcare, groceries, rides to work), and resources given/received. Sandra describes the funds discussed here as falling in the latter category.
3. We thank Max Weselcouch from NYU's Furman Center for providing details on NYC co-op affordable housing.



**U.S.
Financial
Diaries**

The U.S. Financial Diaries Project collected detailed cash flow and financial data from more than 200 families over the course of a year. The data provide an unprecedented look at how low- and moderate-income families—in four regions and 10 distinct demographic profiles—manage their financial lives. USFD was designed and implemented by Jonathan Morduch of NYU Wagner's Financial Access Initiative, Rachel Schneider of the Center for Financial Services Innovation, and Daryl Collins of Bankable Frontier Associates. Morduch and Schneider are the Principal Investigators for the ongoing analysis of the data. For more information, please visit www.usfinancialdiaries.org.



The Financial Access Initiative is a research center housed at NYU Wagner focused on exploring how financial services can better meet the needs and improve the lives of poor households. www.financialaccess.org



Center for
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CFSI is the nation's authority on consumer financial health. CFSI leads a network of financial services innovators committed to building a more robust financial services marketplace with higher quality products and services. www.cfsinnovation.com.

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