



The Spending Plan: Setting and Prioritizing Your Budget Goals

What are budget goals?

Think of your budget goals as your financial wish list and your spending plan as a way to make those wishes a reality. Without clear budget goals, your financial life may remain in disarray. Like any other goals in life, your budget goals help you turn your wish list into an action plan. Your budget goals also help you take the drudgery out of following the budget because, now, when you give up any immediate desire, you know that you are one step closer to something you really want. For example, when you give up having dinner in a nice restaurant, you know that you are closer to being able to take a dream vacation next spring. With clear goals in sight, you can chart your course of action and change your direction when needed.



Start by listing your goals

Setting your budget goals requires forecasting your future needs and dreams. Involve every member of your family and discuss each goal with them. If possible, find a time when everyone in your family is available. Have a brainstorming session with your entire family, and ask each member to make a list of three to five of their possible needs and dreams as individuals and as a family. At this stage, keep in mind that you want to list all of your goals and dreams. Examining them and prioritizing them will come later. Strive to be as specific and unambiguous as possible so that your goals become easier to plan. For example, instead of listing a goal of “taking a family vacation somewhere within next five years,” list “taking a vacation to Florida next summer.” Once each member has made a list, go over all the goals and see if you want to make any changes before you incorporate them into your budget.



Divide up your goals according to how long it will take to meet each goal

Divide your budget goals into three categories: short-term goals (less than a year), medium-term goals (one to five years), and long-term goals (more than five years).

- Short-term goals are your immediate needs and wants, such as buying a dishwasher next month or buying a new car next year. Since these goals are, by definition, less than a year from being realized, they are relatively easy to estimate and plan.
- Medium-term goals are things that you and your family want to achieve during the next five years, such as taking a vacation to Florida or renovating your home. These goals require more planning and careful estimation of their costs.
- Long-term goals extend well into the future, such as planning for your retirement or for your child’s education. These goals require the most planning, including estimating the cost, forecasting your income, and estimating the growth of your investments. You may need expert help to plan for these goals.

Estimate the cost of each goal

Find out how much it costs today

Before you assign priority to your goals, it is important to determine the cost of each goal. The greater the cost of a goal, the more alternative goals must be sacrificed in order to achieve that goal. Though seemingly daunting, the task of determining the cost of your goals is not as hard as you might imagine. For example, to estimate how much your child's college education will cost, call a few college admission offices in your area or look at a college guide. Similarly, you can find out the price of homes in your area or new cars by calling realtors or car dealerships.

Project the future cost

For your short-term goals, inflation is not a big factor, but for your medium- and long-term goals, you need to factor in the rate of inflation so that you have a more accurate estimate of their costs. Inflation can be a very tricky issue in dealing with long-term goals. Even a relatively modest inflation rate can increase the cost of your goal by 2 ½ times over a 20-year period. However, there is no need to panic, since time is also your ally. If invested properly, the money you will be saving toward that goal can also grow at a rate that will outpace inflation.

To calculate the future cost of your goals, you need to determine the rate of inflation that will apply to each particular goal. Often, prices change in different industries at different rates. For example, the real estate prices in your area may rise at a different rate than college education costs. There are three ways to estimate the rate of inflation for your goal. You may observe current and past inflation rates and make some assumptions as to the rate of inflation for the period of your goal. Or you may find out what experts are predicting in the industry in which you are interested. For example, if your goal is to buy a new car, find out the rate of inflation for the auto industry by reading financial newspapers. Alternatively, you may call a local economist at a college or a financial planner for their assumptions. By finding out what it costs today and factoring in the rate of inflation, you can now project the cost of all of your goals in the future. It is crucial that your estimate be as accurate as possible, especially for your long-term goals.

Calculate how much you need to set aside each period

Once you have some idea about the future cost of your goals, your next step is to determine how much you should put aside each period to meet all your goals. Keep in mind that you may not need to assign a separate savings or investment account for each goal as long as you have a method to keep a record of your goals. You may want to have a separate investment strategy, however, for your short- and long-term goals.



For your short-term goals, it is easy to estimate the cost, the amount you will need to set aside each month, and your projected income during that time. Divide the cost by the number of months until you need to meet your goal. You then know the amount of money you need to put aside each month for your goal. For example, if you want to buy a dishwasher in five months and it costs \$250, you need to put aside \$50 a month for the next five months. For your medium- and long-term goals, it can get complicated, since you also need to take into account the interest you will earn on your savings. Computer programs are available to calculate your monthly requirement for your future goals, taking into account interest earnings. You may also project the amount of interest your money will earn at a specific rate of return. Subtract this amount from the future cost of your goal to find out how much more you need to save to meet your long-term goals.

Example(s): If you are saving for your child's college education and you will need that money in 10 years, you first find out the amount of money you will need, taking into account the rate of inflation. Say, for example, you will need \$30,000 for the first year of college. Now, calculate the amount of money you will need to save each month, taking into account the estimated rate of return on your savings or investments.

Once you have calculated this number for all of your goals, you get an amount that you will need to save every month. Then you need to evaluate your goals in order of their priority so that you can channel your savings in the right direction.

Prioritize your goals

Once you have a list of all your goals and the estimated amount needed for each goal, prioritize those dreams. Unfortunately, for most families and individuals, it is not possible to realize all goals, which is why setting priorities is essential. Prioritizing your goals also makes it easier to decide which path to take when life throws you a curveball.

Review your goals and give each a number that reflects its priority. For instance, a number one would mean the goal is extremely important to you. Examples might be saving for your retirement, saving for your child's education, or saving for a down payment on a house. Goals with a number two are somewhat important to you, such as taking a vacation or replacing your car. A number three reflects any goal that is more of a wish than a need, such as buying a vacation home or a boat.

Your first focus will be on the goals marked with a number one. Calculate the amount of money you will need to put aside each month to meet these goals. Do the same for goals with priority number two, followed by those for number three. You can then write your goal schedule.

Create a schedule for meeting your goals

List all your goals according to their priority. Then write down the amount of money needed, when you will need it, and how many installments you will need to meet your goals. With a clear picture of your goals, their priority, and the amount of money you need to attain those goals, you can move to the next step — developing a spending plan for your budget.



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