John and Marcia: Monthly Spending Plan

John and Marcia are a young married couple. They have a two-year-old child named Ashley and a goldfish named Shark. John manages a local shoe store. Marcia recently graduated from college and is a manager-trainee at a local bank. Their combined monthly income is $5,200. They want to have a successful marriage, and they want to be financially successful.

John and Marcia have enough income to provide an adequate lifestyle. Their apartment is comfortable but not lavish. They take care of themselves, Ashley, and Shark with sensible diets, exercise, and medical care. They view maintaining health, life, disability, and renter's insurance as essential. They pay for childcare at Terrific Tots Day Care so that both of them can work. They keep up with all their financial commitments, such as making payments on Marcia's college loan. They regard saving for retirement as important. Like other individuals, they are locked into their fixed expenses, but they have more flexibility with the variable expenses.

Marcia and John know that they want a second car. It is difficult to manage their complex schedules—work, day care, grocery shopping, and trips to the doctor—with only one car. They recently set a goal to save up enough money in one year for the down payment on a second car.

John and Marcia are regular savers. They practice the idea of "paying yourself first." They currently have $175 withheld each month from their paychecks to provide a fund for emergencies. They plan to increase that amount to $400 each month for the next year to enable them to make a $2,700 down payment on the second car.

The table below lists John and Marcia's "before" and "after" fixed expenses. The only item that has changed in the After column is "Savings withheld." Go to the table of John and Marcia's variable expenses. Determine where John and Marcia can draw the additional $225 for savings from their variable expenses. Complete the table and answer the questions at the end of this exercise.

Monthly Budget	Before	After
Total Income (both spouses work)	**$5,200**	**$5,200**
Fixed Expenses		
Housing	$750	$750
Life and disability insurance	$325	$325
Renter's insurance	$15	$15
Automobile insurance	$80	$80
Student loan	$100	$100
Savings withheld	$175	$400
Federal and State taxes	$630	$630
Social Security	$400	$400
Pension fund withheld	$80	$80
Total Fixed Expenses	**$2,555**	**$2,780**

Variable Expenses	Before	After
Meals (at home)	$300	
Meals (away from home)	$250	
Utilities	$315	
Automobile fuel, maintenance	$290	
Medical care	$230	
Child care	$205	
Clothing	$195	
Gifts and contributions	$60	
Magazines and newspapers	$10	
Home furnishings and appliances	$200	
Personal Care	$50	
Entertainment	$260	
Vacation	$120	
Credit Card	$100	
Miscellaneous/personal	$60	
Total variable expenses	**$2,645**	
Total expenses	**$5,200**	**$5,200**

Questions

a. What are some examples of John and Marcia's fixed expenses?

b. What are some examples of John and Marcia's variable expenses?

c. John and Marcia have decided to practice the "pay yourself first" approach to saving for a second car. How do they pay themselves first?

d. Examine John and Marcia's monthly spending plan. What sacrifices do you think John and Marcia should make in their variable expenses to meet their goal? Note: At-home food expenses can't be reduced below $220.

e. What are the benefits and costs of your recommended decisions for John and Marcia?

Can John and Marcia Afford the Home of Their Dreams?

Four years later, John and Marcia are pleased with their financial decisions. They have been able to reduce their expenses to purchase the second car. They have enjoyed the convenience of owning a second car, their income has increased, and Marcia's college loan has been paid off. But new challenges have arrived. The car payment is greater than the college loan was. While having two cars has made life much better, the extra car has added to insurance and car expenses. Also, increased income means the couple pays more in taxes and Social Security.

Marcia and John know that to be financially successful they need to begin acquiring better assets. Owning a home is on the top of their personal and financial wish list. They have saved $10,000 for a down payment on a $150,000 home.

Answer the questions below to determine whether John and Marcia can afford to purchase the home.

a. Use the table below to determine the monthly house payment for a 30-year, fixed-rate mortgage loan at 6 percent. To use the table, go down the column on the left to find the loan amount you want and follow across to the interest rate available. The figure on the table represents your mortgage payment of principal and interest (PI). For example, a $100,000 mortgage with an interest rate of 6.5 percent would have a monthly payment of $632.

What would the monthly payment be for John and Marcia's home loan? ________________________
(Hint: $150,000 – down payment = loan amount.)

Loan Amount	Interest 6%	Interest 6.5%	Interest 7%	Interest 7.5%
$100,000	$600	$632	$665	$699
$110,000	$660	$695	$732	$769
$120,000	$720	$758	$798	$839
$130,000	$780	$822	$865	$909
$140,000	$840	$895	$932	$979
$150,000	$900	$948	$1,049	$1,101
$160,000	$960	$1,011	$1,065	$1,119
$170,000	$1,020	$1,074	$1,131	$1,189
$180,000	$1,080	$1,138	$1,198	$1,259
$190,000	$1,140	$1,201	$1,264	$1,328
$200,000	$1,200	$1,264	$1,331	$1,398

b. The monthly payment covers Principal and Interest (PI), but John and Marcia also would need to pay for insurance and real estate taxes (TI), which total $210 each month. So their total house payment, which includes PITI, equals how much?

c. A rule of thumb for some lenders is to qualify you for a mortgage if the payments you would incur meet two criteria: a) the mortgage payment with taxes and insurance will be less than 28 percent of your monthly gross income, and b) the monthly mortgage payment of principal, interest, taxes, and insurance (PITI) plus other monthly consumer debt (such as a car loan and credit card payments) will not exceed 36 percent of your gross monthly income. John and Marcia have $430 of monthly consumer debt, including a car loan and credit card payment (see budget on Exercise 8.3). Their monthly gross income is $5,200. Using the two lending criteria, would John and Marcia qualify for the loan they are considering, based on your answers below?

$5,200 x .28 ______________________

$5,200 x .36 ______________________

d. As homeowners John and Marcia will have to pay higher utility costs. They expect to budget $365 per month for utility payments. However, one of the benefits of homeownership is the ability to reduce your income taxes by deducting mortgage interest expenses. If they become homeowners, John and Marcia will pay $3,000 less annually in state and federal income taxes during the first year (which means their fixed expenses in this category would decline by a monthly amount of $250). John and Marcia have calculated their budget expenses after buying the home to be $3,240 for fixed expenses (including $400 for saving) and $2,260 for variable expenses, for a total of $5,500.

Do John and Marcia have enough flexibility in their budget to accommodate the additional costs of home ownership (mortgage payment, taxes, insurance and higher utilities)? Why or why not?