How to Make a Personal Budget

A monthly budget allows you to plan how much you will spend or save each month and track your spending habits. Budgets rely on balance - if you spend less in one area, you can spend more in another (or save that money for a large purchase, to build a "rainy day" fund, increase your savings, invest in building wealth, or vacation).

A budget only works if you are honest about your income and expenses. Ultimately, the result of your new budget will show you where your money is coming from, how much is there, and where it all goes each month.

To create a budget that works and allows you live a comfortable and happy life, you need to get a firm handle on what you're currently spending, what you can afford to spend, and what your priorities are.

While you can use old-fashioned pen and paper to budget your money, you can use a budgeting app or the envelope method.

Best Budgeting Apps

- Best Overall: **Mint**
- Best to Keep From Overspending: **PocketGuard**
- Best for Type-A Personalities: **You Need a Budget**
- Best for Just Budgeting: **Wally**
- Best for Cash Style Budgeting: **Mvelopes**
- Best for Couples: **Goodbudget**
- Best for Investors: **Personal Capital**

1. Gather Your Financial Paperwork

Access information about your income and expenses to create a monthly average. This might include bank statements, paystubs, and credit card bills. Use the last three months of this information to identify all your spending.

2. Calculate Your Income

Figure out your monthly income. If you're on salary, your take home pay consistent, taxes are automatically deducted, and you'll use the net income/take-home pay amount. If you are an hourly worker, self-employed, or have a side gig, income may vary so you'll use your lowest-earning month in the past year as your baseline income.

3. Create a List of Monthly Expenses

Make a list of all the expenses you expect to have each month. This list could utility bills, rent/mortgage, auto loan, car insurance, health insurance, student loan, groceries, gasoline, childcare, eating at restaurants, self-care (like coloring your hair or having a massage).

4. Determine Fixed and Variable Expenses

Fixed expenses are mandatory expenses that you pay the same amount for each month, rent/mortgage, car payments and insurance, healthcare, or cell phone service.

**If you call your utility companies, most will give you a fixed rate based on your average usage of that service (for example you might spend more money watering your lawn in warm months than cold months, so they can average those variable charges and give you a fixed rate to pay each month).

Variable expenses change from month to month, like groceries, gasoline, travel, Christmas gifts, eating at restaurants, and self-care.

*If you don't have an emergency fund, include a category for "surprise expenses" that might pop up over the month and derail your budget.

*If you have a pet, try to put a few dollars into an envelope each month to help cover vet costs when they need it.

Assign a spending value to each category beginning with your fixed expenses, then estimate how much you'll need to spend per month on variable expenses.

If you're not sure how much you spend in each category, use an average of the last 3 – 4 months to make a rough estimate. You can tweak these amounts over the first 3 - 4 months until you find a good fit.

5. Total Your Monthly Income and Expenses

Consider adopting the "50-30-20" budgeting philosophy where essential expenses (fixed expenses) should represent 50% of your budget, wants (variable expenses) should make up another 30%, and savings and debt repayment should make up the final 20% of your budget.

If your income is higher than your expenses, you are off to a good start. This extra money means you can put funds towards areas of your budget, such as paying off debt, savings, or retirement.

If you have more expenses than income that means you are overspending and need to make some changes.

6. Make Adjustments to Expenses

If expenses are higher than income you need to find areas in your variable expenses that you can cut or reduce like cable TV, a gym membership, or spa manicures.

Aim to have your income and expense columns to be equal. This equal balance means all of your income is accounted for and budgeted toward a specific expense or savings goal.

If you're not confident that you can budget your money, adopt the envelope method where you divide cash for spending into separate envelopes for different spending categories. When an envelope becomes empty, you'll have to stop spending in that particular category. It literally helps you "see" how much money you have left to spend and still stay on budget.

As you use your budget, keep an eye on how much you have spent. Once you have reached your spending limit in a category, you will either need to stop that type of spending for the month or move money from another category to cover additional expenses.

Your goal in using your budget should be to keep your expenses equal to or lower than your income for the month.

7. Review and Tweak

Circumstances change. Our priorities shift, we change jobs, we move, we have children. Make an appointment with yourself every few months to sit down with your budget and make sure it's working for your current goals and realities.

How to Use the Envelope Method

The envelope method divides your income into different spending categories—bills, groceries, gas, and so on. Once you've decided how much you should spend on each category, you'll take that amount in cash and place it into envelopes. Then, only spend what's available in that envelope for that category's bills or purchases. The aim is to prevent you from overspending by limiting what is available to spend.

Even if you no longer use cash to pay bills, the principle still works and can be applied using software or other financial technology (i.e., setting up auto-pay from your online bank account each month).

The strength of envelope budgeting is that it forces you to stay in touch with spending habits because once the envelope is empty, you can't spend from that category until the next paycheck replenishes the envelope.

1. Establish Categories and Limits

To use envelope budgeting, first establish your personal budget.

2. Label Each Envelope

Using one envelope per spending category, write the name of each category and the monthly budgeted amount on the envelopes.

3. Separate Funds

For this (completely unrealistic simplified) example, assume you are paid $1500 twice a month ($3000 total). Cash your paycheck and put the allocated amount for each budgeted category into the respective envelope. It helps if you know how many $100, $50, $20, $10 and $5 bills you'll need so you can put the correct amount in each envelope. Keep in mind lots of places won't break 100s or 50s:

Income	$3,000	
Expenses		
Rent/Mortgage	$1,000	write a check or use your bank's online automated bill pay (so you have a record)
Healthcare	$200	your bank's online automated bill pay
Utilities (water, gas, phone, cable)	$300	your bank's online automated bill pay
Car payment	$200	your bank's online automated bill pay
Car insurance	$100	your bank's online automated bill pay
Savings	$200	bank transfer
Gasoline	$100	five $20 bills for envelope
Groceries	$200	four $50 bills for envelope or load it onto a gift card for fuel points
Personal care (haircuts, clothes, pedicure)	$150	three $50 bills for envelope
Vet bills (if you have a pet)	$30	one $20 bill and one $10 per month for envelope (to make a dent in large random expenses)
Going out for fun	$220	eleven $20 bills for envelope
Subtotal:	$2,700	sSpent/allocated for bills
Remaining/Unspent dollars:	$300	use this to pay off debt like credit cards, student loans, build an emergency fund, or invest
		**withdraw seven $50 bills, twenty-two $20 bills and one $10 bill from the bank

4. Spend from the Envelopes

With direct deposit for paychecks, electronic funds transfer, debit cards, credit cards, and checks, cash envelope budgeting may seem obsolete, but it's a mind game - when you see tangible cash in an envelope and have to determine whether to spend it now, later, or at all – it helps reign in your spending and choose more wisely.

However you can use budgeting software that is built around envelope budgeting principles and still maintaining the discipline of envelope budgeting. Software such as You Need a Budget uses virtual "envelopes" to represent budget categories and to show spending activity and balances for each category. When income is recorded, the software distributes a portion to each "envelope." When a purchase is made, tell the software which spending categories to use and the software deducts the money from the "envelopes."

Bills that are paid directly cause the software to remove the payment amount from the appropriate envelope. If you use a credit card as a payment method, the software can set aside that amount in a credit card payment "envelope" or category to be used when you pay the credit card bill.

If you have any money left over in your envelopes at the end of the month, you can keep it in that envelope for the next month, or add it to savings or your emergency fund.