CHAPTER 6

Pay yourself first

> Do not save what is left after spending but spend what is left after saving. – Warren Buffet

One of the most important financial lessons I have ever learnt is that it is not how much money you make that matters, but rather what you do with your money that will ultimately determine your financial success.

Working in the banking industry and now as a mortgage broker running my own finance business, I have seen so many examples over the years of people on low to moderate incomes building multimillion dollar property portfolios and having hundreds of thousands of dollars of savings in the bank. I have also seen plenty of examples of people earning six figure incomes who struggle financially and can't even save a deposit to purchase a home to live in.

So naturally, I wanted to understand why this happened and why some people get ahead financially and can live life on their terms, whilst others struggle financially until the day they die. It quickly became crystal clear to me that those that had achieved financial freedom all had one very important thing in common. Whilst they were all from different backgrounds, on different incomes and occupations and had different family circumstances, they all paid themselves first. In other words, for every dollar they received, they would always put aside a percentage of that income towards investing and a percentage of the income towards rainy day savings before they paid their bills or spent money on entertainment or living expenses.

Key Message

Paying yourself first is about prioritising your family and your future. It is about making the decision to take control of your finances and ensuring that you are allocating a percentage of all your income towards your financial future.

It is human nature for us to spend every dollar we have access to and unfortunately most Australians, regardless of whether they earn $50,000 or $500,000 per year, spend every cent that they make (and often spend more than they make). Especially in a world full of temptations, it is extremely easy to spend your entire income without really understanding where the money has gone. The best way to make sure you break this pattern and take control of your financial future is:

1. Identify areas where you can save money,
2. Make a commitment to yourself as to the percentage of your income that you are going to set aside to pay yourself first, and
3. Make it automatic.

Let's go through the steps together.

Step 1: spending 20% less (how to find savings)

Poor people spend their money and save what's left. Rich people save their money and spend what's left. – Jim Rohn

As discussed above, the first step to paying yourself first is to spend less and save more. Now if you are like most Australians, who live from pay check to pay check and spend every dollar that you currently earn, then it may sound like a scary concept to you to reduce your spending money and live on a reduced percentage of your income as I have suggested. You might look at your situation and current lifestyle and think this is impossible, but the funny thing is that you most probably had a time in your recent past when your income was less than 80% of your current income and you were still able to get by and survive. Where did that extra income go? The truth is, we can all survive on less income if we try. We all currently waste money, but we may not be aware of where we are wasting it.

For most Australians, it is a natural habit to spend more as they make more and you may have fallen into this trap over the years. If you think about all the pay increases you have had over the course of your career, have you allocated the extra income to something productive like investing it, or has it just disappeared and you are not sure where it went? We all can live on less income without significantly impacting on our lifestyle but we may have to be prepared and committed to make changes.

Change is hardest at the beginning, messiest in the middle and gorgeous at the end. – Robin Sharma

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The first step is to revisit the cash flow exercise you did in Chapter 5. If you did this properly, chances are you can easily find savings without having to make any substantial changes to your lifestyle.

For example, when I started working in the city, I got into the habit of buying my lunch every day. Because I monitored my spending, I quickly realised that whilst I was only spending on average $12/day on my lunch, this equated to $60/week, which equates to $3,120/year. By changing my habit and bringing my lunch into work with me, I was able to save a substantial amount of money. And it was easy once I got into the habit of making a little extra dinner so that I would have enough leftovers to take into work with me the next day. Similarly, my husband is a coffee lover and would go to the local café 4-5 times a day to get a take away coffee. This was equating to $25/day or $6,500/year. By changing his habit and making his own coffees at the coffee machine at work and only buying 1 coffee/day, he was able to save over $5,000/year. I challenge you to think hard about the changes you can make in your spending that will allow you to save some money. To help you identify areas of savings I have included a list of suggestions at **www.risehighinvestor.com.au/ch6**.

Chapter 6 – Exercise 1 – Identify savings and prepare a budget

1. Revisit the cash flow exercise you did in Chapter 5 and the areas you highlighted. Identify three things you can change to start saving money instantly.

2. Using the cash flow template that is available on the webpage **www.risehighinvestor.com.au/bonus/ch6** create an ideal budget (considering your proposed changes) to identify how much money you can save by making those changes. This can be a useful budgeting tool to guide you in your spending moving forward. Whilst some people view a budget and monitoring your spending as restrictive, I believe it is the complete opposite. By having a clear budget and understanding where your money is going, you have complete clarity and control of your finances and have complete power over how and when you spend your money. Instead of living from week to week and splurging on impulse buys, having control of your finances will put you in the driving seat and ultimately give you the financial freedom you desire and deserve. Having a budget is not about making sacrifices, but rather about being smarter with your money and being in control of how you spend your money so that you can improve your lifestyle now and in the future.

Step 2: make a commitment as to what percentage of your income will be paid to you first

Once you have identified areas where you can save money, you will have a good idea of how much you can allocate towards building your wealth. The key here is that you have to make an absolute commitment to yourself on the percentage of your income that will go towards investing and the percentage that will go towards emergency, rainy day savings. Once this commitment is made to yourself, you have to keep it. You can decide what percentage is right for you and it has to be achievable on an ongoing basis.

If you can, I recommend a minimum of 10% of your total income to be allocated towards your investment fund and 10% to be allocated to your emergency fund. But if you want to achieve financial freedom sooner, the more you can allocate to these accounts (particularly the investment account), the faster you are going to achieve financial freedom and achieve your financial and lifestyle goals.

Step 3: how to ensure you pay yourself first

Once you have identified your savings and made a commitment on the percentage of your income that will go towards investing and emergencies, the best way to ensure long-term success is to make the process automatic. A great way to get started is to open three different bank accounts.

1. The first bank account is where your income is paid into and where your bills and living expenses come out of. This bank account is linked to an ATM card and you have internet banking access to make internet payments from this account. Nickname this account on your internet banking ‘everyday account’.

2. The second bank account is your investment bank account. Nickname this account on your internet banking ‘investment account’.

3. The third bank account is your emergency bank account. Nickname this account on your internet banking ‘emergency account’.

Ideally, it would be great if all three of these accounts could offset your home loan, so speak to your Mortgage Broker about whether this is possible.

The investment and emergency accounts should not be linked to ATM cards, and it should not be easy for you to be able to spontaneously access the money in these accounts. Once money goes into these accounts it is important that it is not taken out of these accounts for any purpose other than what it is supposed to be used for.

For example, the money in your investment bank account is money that you have available to invest into building your property portfolio, whilst the money in your emergency account is strictly for emergencies. When I say emergencies, I am not talking about instances where you need to get a new outfit for the party on the weekend or you desperately need a holiday. I am talking about real emergencies like your hot water system or fridge breaking down and needing to be replaced.

Once you have your three separate accounts, you could ask your employer to split your pay into three separate accounts, so that 10% automatically goes into your investment account and 10% into your emergency account before you even see your pay. If your employer is not able to do this, you can set up automatic periodic transfers on your internet banking, programed to transfer 10% of your income to each of your investment and emergency accounts on the day that you will receive your pay.

If you are self-employed, every time you receive income into your business, just as you would put aside 10% for GST, at the same time you should be transferring 10% into your investment account and 10% into your emergency account.

The easier you can make the process and the more automated the process is, the better your chances of sticking with it and turning your life around. The most important thing is that you make a commitment to yourself to make this your new way of life. If you find yourself having days or weeks when you are tempted to stop paying yourself first or to take money out of the investment and emergency accounts, it is extremely important that you go back to your dream board and the long-term goals you set yourself when you read Chapter 1, to remind yourself of why you are doing it and keep yourself on track.

Chapter 6 – Exercise 2 – Make it automatic

Set up your bank account structure and make the required changes to your pay to ensure that you are automatically paying yourself first before you spend any of the money you earn. To help you with this you can download a page of instructions that you can take to the bank with you when setting up your new account structure. These instructions are available at **www.risehighinvestor.com.au/bonus/ch6**