The 50/20/30 Rule of Budgeting

The 50/20/30 rule of budgeting pretty simple to understand, but implementation is where things get hairy. Basically, this serves as a way to break up your monthly/weekly/yearly income into manageable sizes for each category of your life - basic necessities, debt and savings, and enjoyment.

50% for Basic Necessities

The 50% of 50/20/30 is the portion of your income that should cover your basic necessities. This includes rent, food, and any bills. Depending on where you live, this portion may go up or down. Starting salaries in big cities with high growth potential can prove difficult, considering the high cost of food and rent. However, as long as you are cautious and aware of your situation, this shouldn't be a problem.

A lot of people neglect their necessary monthly expenses when planning out their budgets. Bills might be estimated at $100 for electric, but what about gas, insurance payments, or small but recurring medical payments (such as vitamins or a prescription with a small copay)? These should all be counted in your basic necessities bucket, along with groceries and sometimes fluctuating amounts for gas.

On the bright side, sometimes you can find an apartment with many utilities included. Not only does it save you the stress of having to remember to pay another bill, but it also allows you some wiggle room in your 50% of basic necessities. Perhaps, after looking at your previous month's expenditures, you realize that almost all of your necessities go into caring for the place you live. This is a good indicator that you can add some additional money to your savings, or even treat yourself once in a while.

20% Goes to Savings

The 20% of the 50/20/30 rule is probably the most important part of the rule. This is the portion that gets allocated either to long-term debts or savings.

A lot of people misassociate large payments with long-term debts, which can lead to an off-balance budget. The only debts that should be included here are car loans, student loans, personal loans, or credit card debt. Mortgage payments should be included in the 50% for basic necessities, as a replacement for rent payments. Basically, anything that could majorly screw up your credit score if you don't pay it back should be listed here (again, aside from a mortgage).

This is the category that people will find easiest to cut, because you find no gratification in paying off a debt or contributing to savings. You don't get anything from it, and you aren't able to show anything for it. Your quality of life stays the same - for now. Over time, this is the category you will most regret ignoring. Putting money toward loans earlier rather than later will reduce interest rates and raise your credit score. Neglecting payments will result in a deduction in your credit score, which could severely impact your chances at a low loan rate for a house or car, resulting in even more money out of your pocket.

After all debts are paid off, the same amount of money should be contributed to savings. The easiest way to do this is to take almost no notice in paying off full debts, and instead funnel the money directly into a savings account. While paying off debts, money is continually being taken from you, but as soon as you flip the switch to a savings account, your money is compounding on itself and growing. If your debts are small enough, you can even contribute a small amount of this 20% to savings while continuing paying down debt.

Just like the basic necessities category, there is some wiggle room in this 20%. Perhaps the most important debt to showcase this is student loan debt. People are graduating from college with loan payments as high as (some even higher than) $1000 a month. In this case, 20% could grow to 50% or even higher, and both the basic necessities category and fun category will have to take the hit, which will include a smaller or less central place to live to lower rent/mortgage payments, and a huge cut to any non-essential activities.

When budgeting, take into consideration all of the debts you need to pay off, and really question whether you need it. A $300 car payment every month cuts a huge chunk out of your 20%, assuming you have a starting or entry-level salary. Buying an older car and diverting this money to debt/savings can reap you a ton of money in the long run, and improve your current way of life.

The last 30% of Your Income - The Fun Part!

The last 30% of your budget is the easiest to both spend and understand. This is simply the portion of your budget that should go to doing the things you enjoy doing. It should still be budgeted in a way it'll last you all month, but it's ultimately up to you how to spend it. A good way to make it last a little further is to aim to add the ending balance of your fun budget back into your debt/savings budgets.

Like most budgets, 50/20/30 is a suggestion that works for some people but might change depending on your specific situation. The easiest way to manipulate it to fit your needs is to take a quick audit of your current debts and obligations, then reverse-engineer your percentages so you have consistent numbers to work off of. If you live with roommates, your 50 will shrink, allowing more fun and savings. If you have higher amounts of debt, your fun budget will shrink.

Taking a practical and quantitative approach to budgeting will take away the emotional distractions of reallocating a budget based on what you want, rather than what will be financially best for you.