Building Your Net Worth

What to Know

Calculating your net worth is easy: Assets – Liabilities = Net Worth. But your net worth is more than a number. It represents the relationship between four factors:

1. Your Income
2. Your Monthly Expenses
3. Your Assets
4. Your Liabilities

To build your net worth, you need to be in control of all four of these factors.

What to Do

Review the stability and dependability of your earned income

To build your net worth, first evaluate the stability and reliability of your earned income (e.g. your wages, salary and bonuses if applicable). If you plan to build your net worth based on overly-optimistic expectations of salary or wage increases, or the sustainability of a second job, you may fall short on meeting your wealth-building goal. How stable and dependable is your current and near-term income?

Reduce your monthly expenses

In simple household terms, there are basically four types of expenses: fixed ("have to"), variable (both "have to" and "want to"), discretionary ("want to!") and extraordinary (Murphy's Law):

- **Fixed expenses** typically include **necessities** like your mortgage or rent payment, utilities, loans and lease payments, and other fixed monthly expenses.
- **Variable expenses** generally include things like gas, car maintenance, certain utilities, groceries, clothing, school supplies and personal care.
- **Discretionary expenses** generally include things like specialty groceries and coffee shops, dining out, movies, theatre, concerts and club memberships.
- An **extraordinary expense** is the **unplanned** expense like a major car repair or a medical emergency.

To get a handle on where your dollars and cents go, track your spending over a two-month period. Tracking your spending will help you identify the difference between "have to" spending and "want to" spending that when combined create a spending pattern that may impair your ability to build your net worth through a financially healthy and disciplined approach to saving and investing.

Acquire assets that are more likely to provide income or appreciation potential over the long term

What you own is called an "asset." But not all assets are created equal. Some types of assets are more likely to help build your net worth over the long term, while others may actually reduce your net worth. For example, assets with income or appreciation potential may help build your net worth. Examples include: bank certificate of deposits, treasury notes and bonds, real estate, individual stocks and bonds, exchange traded funds, and mutual funds. Assets that may negatively affect your net worth over the long term are assets that are more likely to depreciate in value. Examples include all sorts of material wealth items with a limited life span like electronic equipment, cars, boats, snowmobiles and jet skis.

Maximize contributions to IRAs and employer-sponsored retirement plans

IRAs and retirement plans are great ways to accumulate assets with income or appreciation potential. For employer-sponsored retirement plans, it's generally recommended that you contribute a minimum of 15% of your gross pay or the maximum amount allowed by the IRS. Many employers offer matching contributions. This "free money" may contribute significantly to the building of your net worth over the long term. Any employer match is a 100% return on your contributed money and it doesn't get any better than that!

Reduce your liabilities

What you owe is called a debt or "liability." You create a liability when you decide to borrow money or use a line of credit like a credit card. A liability isn't payable immediately. Instead, it is typically payable at a future date or over a longer time period with periodic payments. Some liabilities can act like a boat's anchor that drags along a lake's bottom, slowing down your ability to build and grow your assets.

Like assets, not all liabilities are created equal. The types of things you have loans against can affect your net worth over the long term. For example, loans on assets that have the potential to appreciate in value, or a loan for college or trade school are different than from loans used to purchase depreciating assets or whose value declines with age. For example, having a loan on a jet ski which is likely to depreciate in value, is different from having a loan on a new home in a growing community, which is different from having a student loan for trade school which may result in you earning a higher lifetime income.

When you swipe your credit card you create a liability. Strive to pay off the full balance on your credit cards each month, if possible.

Final Notes

- Your net worth will naturally fluctuate. Market-related factors may significantly increase or decrease the value of your assets, especially over the short term.
- Reducing your debt will have a positive effect on your net worth, and taking on new debt will have a negative effect.
- Calculate your net worth annually and track your progress.

Where to Turn

For more information on building your net worth, budgeting, credit and debt, visit the Michigan State University Extension website www.msue.anr.msu.edu/program/info/mimoneyhealth

Michigan State University Extension helps people improve their lives by bringing the knowledge resources of MSU directly to individuals, communities and businesses.