How to Create a Personal Financial Statement
Presented by Christa Canavan

Similar to a company's financial statements, a personal financial statement can help you assess your financial health and assist you in budget planning. It can also give you an idea of the kinds of information that banks and other lenders use to determine your ability to repay loans. Curious to know where you stand? Here, we show you how to get a handle on your finances by creating a personal financial statement.

Your personal financial statement
A personal financial statement consists of two parts: a net worth statement and a cash flow statement.

Net worth statement. To create your net worth statement, start by listing all your assets at their fair market value, in order of how easily they can be converted into cash. It's helpful to group assets into three categories: cash or cash equivalents, invested assets (your investment portfolio), and use assets (your home, furniture, automobiles, and so on). Then, list your liabilities—what you owe—in order of their maturity date. Be sure that your list of liabilities agrees with the credit bureaus' reports. Now, subtract your liabilities from your assets to determine your net worth. For you to be considered solvent, your liabilities should represent no more than 90 percent of your assets.

Cash flow statement. The second part of your personal financial statement is your cash flow statement. It compares funds coming into your household, such as salary and investment income, with money going out, including savings and expenses. Tally these numbers for a certain period of time (a month is a good place to start), and then calculate the difference between your cash inflows and your cash outflows. A negative cash flow statement indicates that you can't cover your expenses for that period without dipping into your cash savings and investments.

What do lenders typically look for?
While credit history is important, lenders look for sufficient stable income to support loan payments and sufficient collateral to back your promise to repay the loan. Liquid assets have the most weight, and lenders will typically adjust the estimated value of hard-to-sell assets on your net worth statement. Here's how different types of assets tend to fare in lenders' eyes:

- **Cash:** An emergency fund is an important part of any financial plan, and it can be particularly helpful when applying for a mortgage or other major loan. The typical target is enough liquid assets to replace three to six months of expenses.
- **Investments:** Typically, a lender will look for 15 percent of your portfolio to be invested in marketable securities. Note that a large percentage of margin account securities may raise a red flag in the mind of a loan officer.
- **Closely held businesses:** A lender may adjust the value of a business that is solely dependent on you. Lenders may also discount the value of minority shares because of their illiquidity. Restricted or control stock is considered unavailable as collateral and will be taken off your net worth statement.
- **Real estate:** A lender will adjust the value of real estate based on taxes and other costs if the property has to be liquidated.
- **Notes receivable:** As an asset, notes are only as valuable as the guarantor and may not be taken at their notational value.
- **Personal use property:** Automobiles, boats, furniture, and other personal possessions may have liquidation value but are easy to hide from creditors. Consequently, most lenders will reduce their value on your net worth statement.
- **Life insurance:** For estate purposes, life insurance is listed at its death benefit amount. For other purposes, it is listed at its cash surrender value. A large life insurance loan, while not subject to repayment during your life, indicates a possible liquidity problem.

Lenders will also look closely at your debt-to-income ratio to ensure that you aren't taking on a mortgage you can't afford. To calculate this ratio, divide your total recurring monthly debt costs by your monthly gross income. As a general rule, your debt-to-income ratio must be below 43 percent. Note that lenders will still make loans to borrowers with higher debt-to-income ratios, such as retirees, if other factors justify the risk, such as a high level of assets.

Your personal financial ratios
Together with your personal financial statement, financial ratios can help you analyze your ability to take on debt—or determine whether you have more debt than you can afford. Here are some of the more helpful calculations:

Liquidity ratio. One financial rule of thumb is to maintain an emergency fund comprising:

- Three months of fixed expenses *or*
- Six months of fixed and variable expenses

Keep in mind that it's possible to overfund an emergency fund. You should guard against keeping more than 120 percent of your six-month expense estimate in low-yielding investments. And it's usually recommended that you hold no more than 5 percent of your cash reserves in a non-interest-bearing checking account.

Housing payment ratio. Nondiscretionary housing expenses—such as a mortgage, insurance, real estate taxes, and association fees—should be equal to or less than 28 percent of your monthly gross income.

Total payment ratio (debt ratio). A common mortgage lender standard—and a healthy personal finance target—is to keep all monthly loan and minimum credit card payments plus housing costs at or under 36 percent of your monthly income. Lenders' target debt ratios change with credit availability. Their typical requirement can range from 26 percent to 41 percent, depending on the lending environment and whether the loan will be insured by the Federal Housing Administration.

Consumer debt ratio. Discretionary debt includes credit card and automobile debts or leases. Your total discretionary debt should be less than 10 percent of your monthly gross income. A ratio of 20 percent indicates that you should not take on additional debt.

Savings ratio. There is no standard recommended savings rate. Your savings rate should depend on your age, goals, and life stage. As you get closer to retirement, your savings rate should increase. Direct deposits or electronic transfers can help you make saving a habit, but don't burn a hole in your pocket. Saving to spend is a great alternative to taking on debt, but saving to invest can be just as exciting.

Norton
Financial Consultants

Christa Canavan, ChFC, Registered Investment Advisor

Norton Financial Consultants

165 Main Street, Suite 206-A | Medway, MA 02053

508.429.7000 | 508.429.7409 fax | www.nortonfinancial.com | christa@nortonfinancial.com