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The 4 Pillars of Cash-Flow Management

By Evan Swanson, CMPS

The following model is the basis for successful long-term financial management. In our view, the following four pillars represent, in order of importance, the key to incorporating financial responsibility into a person's life. It is our goal to introduce and educate our clients on how the decisions they make surrounding the house that they buy and the mortgage they select will ultimately affect their financial well-being.

Pillar 1: Creating a cushion

The first pillar in the 4 pillar system involves creating a financial cushion. It is important to have money on hand that is readily accessible for life's little (or large) unbudgeted emergencies. The purpose of this account is to allow a person to pay for these emergencies with cash instead of falling into the all too common habit of using credit.

In calculating how much a person needs to satisfy this first pillar we recommend that a person first estimate their "*survival number*". Their *survival number* is the amount that they spend each month on essential items in their budget such as housing payments, food, utilities, and minimum payments on credit obligations. This amount would allow them to "get by" without spending money on discretionary items such as Starbucks, eating out, and other purchases which could be eliminated if need be.

Once this amount has been established a person can calculate how many months worth of survival reserves they'd like to have. Most financial planners recommend that a salaried person have 3-5 months worth of survival reserves in a safe liquid savings account whereas a self-employed or commissioned earner keeps 5-7 months in reserve.

Pillar 2: Get Debt Free

Once a financial cushion has been established a person can now focus on the second pillar of cash management. Reaching the second pillar involves eliminating all "*non-preferred debt*". Non-preferred debt is all debt which **does not** meet most, if not all, of the following criteria:

→ carries a reasonable interest rate
→ has tax benefits
→ is secured by an asset which is appreciating
→ has affordable payments

In general, non-preferred debt includes all debt that isn't a mortgage (some exceptions apply). That said, our focus is to develop a strategy that will help our client pay-off their non-preferred debt as quickly as possible.

By eliminating these miscellaneous monthly obligations a person is able to free-up additional monthly cash-flow that can then be directed to savings & investment accounts. The key to financial independence is for a person to have control of their money and then conserve it, instead of consuming it.

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Pillar 3: Liquidity

True financial security comes with having liquid funds available at any time. This next pillar is about having 1 year's worth of a person's income or more available to them for either good or bad reasons.

A *good reason* why a person may want this type of money available to them is to take advantage of a business or investment opportunity. Most of the time when a person is presented with an investment opportunity a significant amount of capital is required upfront. If a person has the money to be able to participate then they can do so, but most people are not in a financial position to take advantage of these opportunities when they come along.

An example of a *bad reason* to use liquidity is in the case of a major interruption to a person's income. This may be due to an illness, sudden disability, job lay-off, or economic down-turn outside of a person's control. In this instance liquidity can help fulfill a gap of income and still maintain a comfortable life. By the way, the number one cause of foreclosure in the United States is disability.

Pillar 4: Pay-off your house

This is the point where it can really get exciting. For most people, having their mortgage paid off is a far-off dream that may never come to fruition. But, by focusing on strategies to effectively achieve the first three pillars of this system it can become a very realistic target.

Most people define "having their mortgage paid off" as not having a mortgage on their house. But, wouldn't it also be true if a person had a $300,000 mortgage secured against their home and also had $300,000 in liquid assets? After all, their personal balance sheet would show a $300,000 liability on one side and a $300,000 asset on the other.

This topic raises some very interesting questions and opens up some powerful opportunities. But, if a person has not yet addressed pillars 1 through 3 then does it even make sense to focus on down payments, principal payments, and home equity? The bottom line is that an effective financial plan and strategy will do more for a person's long-term financial well-being than most anything else.