Seven baby steps to financial freedom

With imminent interest rate hikes and the rising cost of living, 2016 is expected to be a difficult year for many consumers financially if they don't currently have a system in place, says Adrian Goslett, regional director and CEO of RE/MAX of Southern Africa. He notes that regardless of whether someone is earning five thousand rand a month or five million, it is important to have solid financial principles in place to be able to get through the tough times and continue to thrive even when the economy is not in an ideal state.

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"There have been many high-fliers who have lost everything because they did not understand the fundamentals regarding finances. Irrespective of the individual's earning potential, the same principles can be used and applied to ensure that the person has a solid financial foundation that they can grow from," says Goslett. "Much like building a home, it is vital to start with a foundation and build upwards from there through a process of steps. Skipping a step will result in a shaky structure that will not stand in trying times."

Goslett points to the financial management system of Dave Ramsey called the 'seven baby steps' as an excellent guideline and starting point. "Dave Ramsey is an author, talk show host and personal finance expert, who has developed a method to help people out of debt and financial stress and into a life of saving and giving. Even having had a successful real estate career, through some bad decisions, Ramsey lost everything and had to start again from nothing. This experience has provided him with hands on knowledge on how to reach financial freedom from a difficult situation," says Goslett.

He provides a guideline to the seven financial steps laid out in the programme:

Build a starter emergency fund

Most homeowners will know that there are always unexpected life events that happen and require additional funding. Regardless of whether it is a burst geyser or leaking roof, things happen and consumers need to be ready. An emergency fund will ensure that the consumer does not have to go further into debt to fix the problem. As an initial goal, it is good to aim for a savings of around R10,000 as a start-up emergency fund.

Pay off debt

Apart from the bond, make a list of all debts from smallest to largest. Debts with the smallest balances are given top priority, as these can be cleared off the list far more quickly than larger amounts. If two debts are similar amounts, then the one with the highest interest rate should be paid off first. The idea is to pay off the first debt and then use that money to pay off the second debt faster. This will have a knock-on effect and will help the consumer to clear all their debt in a shorter period of time.

Three to six months of expenses in savings

Unlike the initial starter emergency fund, this step is to build up a full emergency fund that covers all household expenses for at least three months, but ideally up to six months. This will ensure that the consumer will be prepared for some of life's larger surprises and will be able to stay out of debt for good.

Invest in your retirement

This step in the plan is to build long-term wealth. With no debt and a full emergency fund in place, it is time to focus on putting money aside for retirement. The money that was once used to pay debt can now be used to build a future. Ideally around 15% of the household income should be invested for retirement. There are several retirement fund options available to consumers, so they should be able to find one that works for them. A broker or financial adviser could prove to be a valuable asset at this stage.

An education fund

What better way to prepare your children for the future than to invest in their education. University and all the associated fees can be costly, especially in a multiple-child home. Setting aside money for the children's education will put consumers ahead of the curve when their children leave school and want to study further.

Pay off your bond early

One of the best investments a homeowner can make is to pay off their home loan faster to reduce the amount of interest they pay over the term of the loan. Even a small additional monthly payment can make a big difference to fast-tracking financial freedom for the homeowner. An increase of R500 on a 20-year bond of R1 million at an interest rate of 9.75%, will reduce the term of the loan by around three years and save the homeowner a total of R202,903.

Build wealth and give

The final step of the programme is to live life and be generous. People who have no debt and no payments are free to do anything they would like to do. Exercising discipline for a few years will set you up for the rest of your life. Continue to set goals and budget every month, but have some fun along the way.
"Getting to financial freedom is less about the knowledge and more about the change in behaviour and self-discipline. Having the know-how means nothing until it is applied and put into practise. Making a commitment to change to help consumers go from where they are now, to where they want to be," Goslett concludes.