

# Net Worth Conversion Ratio - A Measure of Wealth Building Efficiency

There is never a dull moment in Personal Finance, am I right? I am not sure if it's just me, but I am constantly think of ways to look at personal finance through different perspectives and lenses. A while back I took a stroll down memory lane to figure out how long it would/had taken me to [earn my first \\$1M](#) in earned income. That analysis got me wondering how much earned income Mrs. GYFG and I had earned on a combined basis (I will share shortly).

But ultimately the reason I wanted to see how much we had earned as a team was to figure out how efficient (or inefficient) we had been at converting our income to wealth (i.e net worth). I can't say for sure if this ratio is original thought or not, but it has been circling in my head for months now.

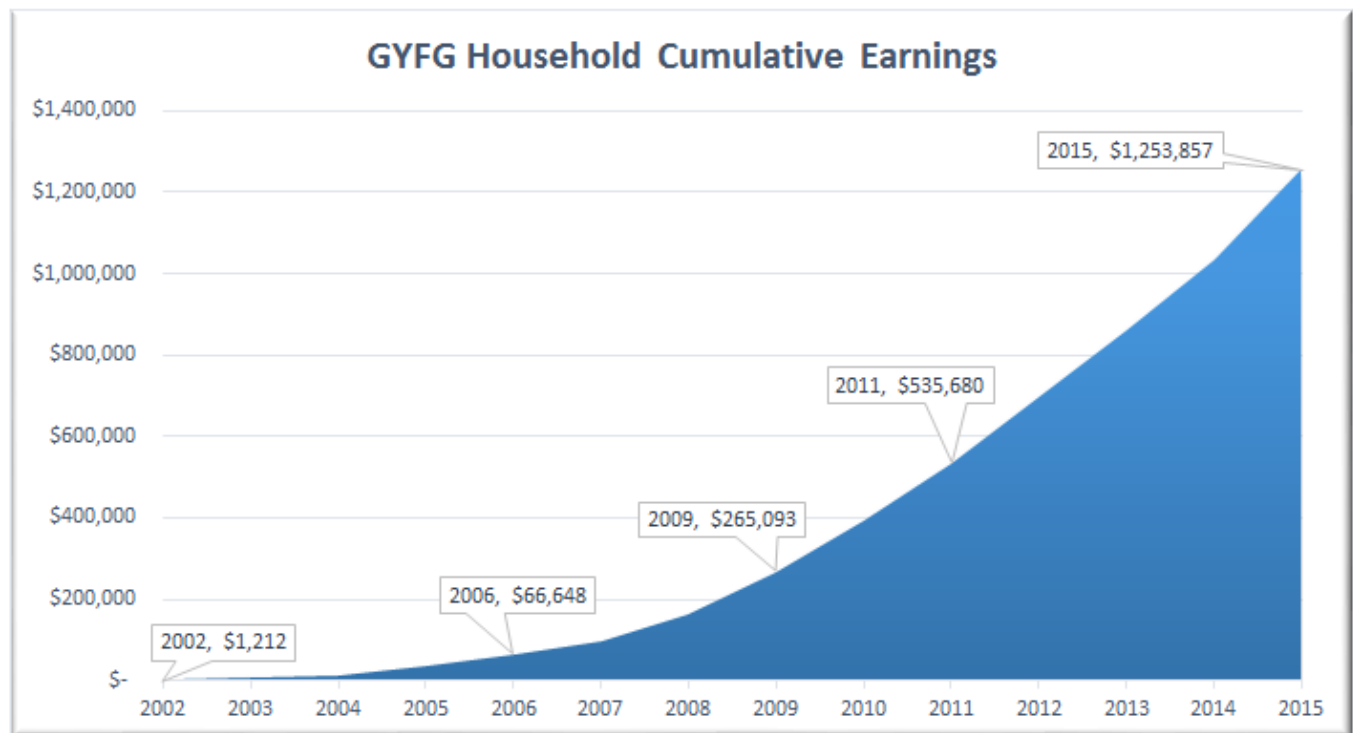
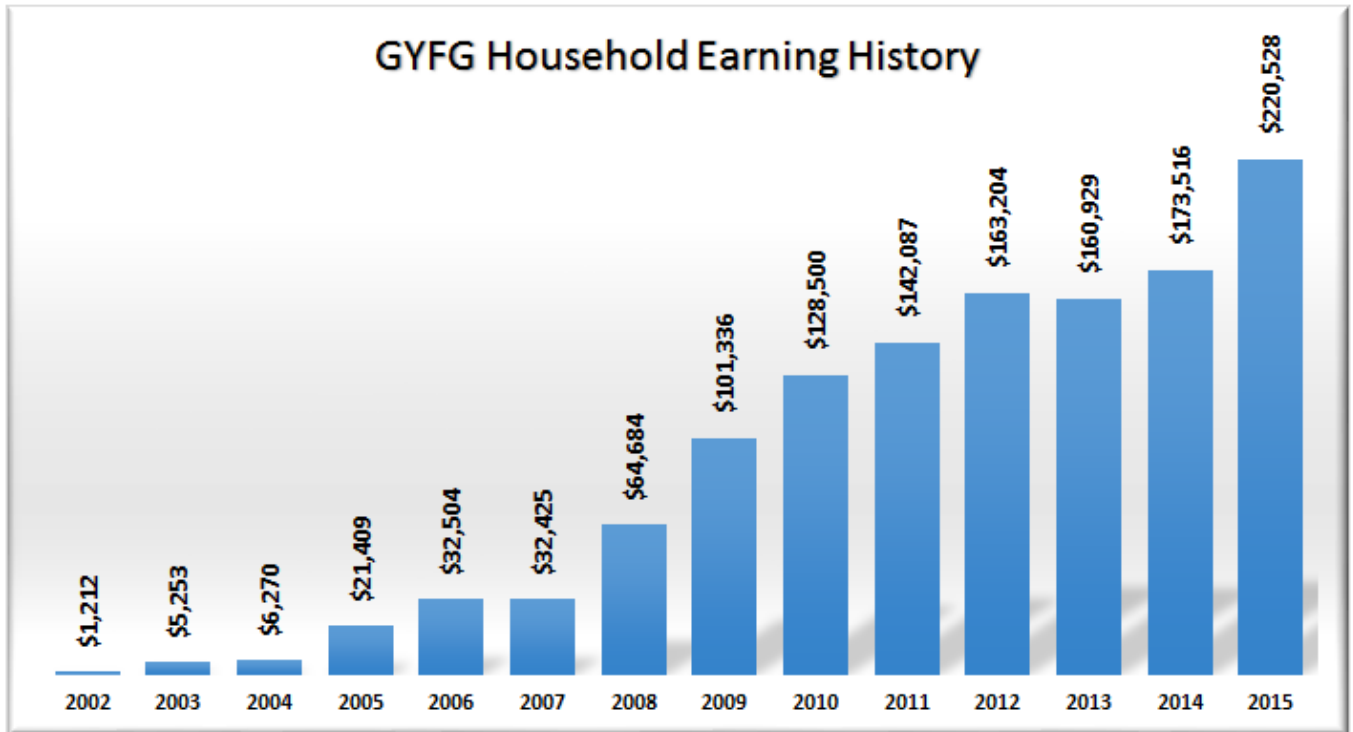
Before we get into the ratio and all that good stuff, let's first cover lifetime earnings for the GYFG household.

## GYFG Household Lifetime Earnings

First, if you ever want to go back in time to figure out what you have earned the [Social Security website](#) has made that really easy (assuming it was on the books). If you read the post I linked to above you would recall my earnings went back to 2003 (at least the ones for a formal employer). My wife has me beat by a year with her first year on the books in 2002.

When I pulled all of these numbers together I was shocked for two reasons:

1. I couldn't believe how much money we had already earned, and we are only barely entering our prime earning years.
2. Based on how much we have earned, I was a bit bummed on how little of that we had converted into wealth.



*Note: This excludes any form of rental income from our condo and from renting out a room in our house. It also excludes any windfalls like gift money. I explicitly point*

*this out in case you have an eye for detail and notice that the numbers here are slightly off the annual income figures I report on my [monthly reports](#) and [financial stats page](#). The short of it is to expect discrepancies, earnings for this exercise will be lower than total income reported.*

## **\$1,253,857 In Cumulative Earned Income From 2002 - 2015**

My first reaction...**HOLY CRAP!**

My first thought after my first reaction...How much of that have we turned into net worth?

My second reaction...**F\*ck, only 25.3%, we have got work to do batman!**

**How did I come up with the 25.3%?**

Our Net Worth at [December 2015](#) finished the year at \$317,727. When you divide that into our cumulative earned income of \$1,253,857, you get 25.3%. We didn't start tracking net worth until 2012, which I suspect is the first year it went positive, but the good news is that this ratio has been improving.

In 2012 we finished December with a net worth of \$42,424 and our cumulative earned income was \$698,884. This would have put what I am calling the Net Worth Conversion Ratio at a measly 6%. So, with that, we have made solid progress with the ratio up more than 4X in just 3 short years.

## **Net Worth Conversion Ratio**

*Definition: The Net Worth Conversion Ratio measures an earner's ability to convert earned income into wealth or net worth. It excludes passive income, since passive income is dependent on the earners decision of putting earned income to work or spending on consumption.*

### **The Variables:**

- **Earned Income:** This part should be fairly obvious. You need an income in order to start building a **positive** net worth. Unless you somehow stumbled on some form

of windfall through inheritance, lottery, or some kind of heist...you are going to need an earned income to get things started.

- **Debt:** You are going to want to avoid consumer debt as this only causes your net worth to decrease. Every time you consume something you can't afford today is stealing from your future self. Even the debt from acquiring a house (which I consider good debt in most cases) is dilutive to net worth and thus your conversion ratio. It's not the face value of the loan, but the interest that erodes the net worth conversion ratio. This helps reinforce our goal of [paying off our mortgage in 7 years](#), which will reduce the lifetime interest significantly.

- **Savings Rate:** Your savings rate [plays a significant role in building wealth](#). If Mrs. GYFG and I had always subscribed to [the law of 50/50](#), our net worth conversion ratio would be something much closer to 50% (plus or minus a few %). Outside of maxing out my 401K early on, our savings was pretty low compared to where we are today. In all honesty, most of this stuff really wasn't on my mind at the time. In the early days we were so focused on getting our careers moving to earn money, that we didn't put much thought into saving and investing. We mistakenly thought income was the sole solution to life's problems. Oh, to be so naive ☐

- **Market Appreciation:** When you put your money to work for you, you have the opportunity for appreciation and depreciation (to be avoided as much as possible). This is true whether you're talking about real estate, stocks, gold, etc. Over a long enough time frame investments should go up over time. However, when you buy depreciating assets like cars, boats, and other toys, keep in mind that depreciation is eating your net worth for breakfast.

- **Passive Income:** In addition to appreciation, you also have the opportunity to earn income in the form of dividends, interest, and/or rents from your investments. If reinvested this helps increase your net worth and improves the ratio without requiring you to earn more money actively.

- **Other People's Money:** The specific example I was thinking of when I added this to the list is rental real estate. You use the banks money to get a loan, and then you rent it out to a tenant and let them amortize the loan for you. You really get a lot working for you in this scenario. You have the opportunity for market appreciation, passive income, amortization of a loan, and tax perks...all of which will have a positive impact on your net worth and the conversion ratio.

## So, What is The Ideal Net Worth Conversion Ratio?

I have been thinking about this a lot. I think there are four major milestones to aim for:

**1** - Your Pre-Tax Savings Rate - For us that would be 37% based on 2016 projections.

**2** - Your After-Tax Savings Rate - For us that would be 50% based on 2016 projects/goals.

**3 - Equal to 100% - This essentially means you have been able to live and enjoy everything in your life for FREE.**

**4** - Financial Nirvana where Net Worth Conversion is greater than 100%.

Ultimately, I think that everyone should aim to achieve at least a 50% conversion ratio. Personally, I am going to try my hardest to make it to Financial Nirvana, just because its sounds like such a magical place. I like the idea of generating wealth that is greater than lifetime earned income.

I really think real estate could be one of the most powerful asset classes to help an earner move towards financial nirvana and a net worth conversion ratio of greater than 100%. All of the factors I laid out above are important, but this is one I will be giving extra attention to in 2016. After looking at this I really am feeling a stronger conviction on adding that 3rd property, but I want to make sure timing, price, and location is right. Getting all our ducks in a row if you will.

Before that third property gets added there are two other things we will be looking to complete:

1. [Refinance our Condo](#) - potentially freeing up \$200/month in free cash flow
2. Refinancing our House - potentially freeing up \$400/month in free cash flow

I won't go into the details now, but look out for future posts on this.

*What is your net worth conversion ratio? Are you where you want to be?*

-Gen Y Finance Guy



## Gen Y Finance Guy

**Hey, I'm Dom** - the man behind the cartoon. You'll notice that I sign off as "Gen Y Finance Guy" on all my posts, due to the fact that I write this blog anonymously (at least for now). I like to think of myself as the *Chief Freedom Officer* here of my little corner of the internet. In the real world, I'm a 30-something former C-Suite executive turned entrepreneur turned capital allocator. I am trying to humanize finance by sharing my own journey to Financial Freedom. I believe in total *honesty* and *transparency*. That is why before I ever started blogging, I decided that I would share all of my own [financial stats](#). I do this not to brag, but instead to inspire motivate, and also to hold myself accountable. My goal is to be a beacon of hope, motivation, and inspiration for *you*, the reader, by living life by example and sharing it **all** here on the blog. My sincere hope is that you will be able to learn from me - both from my successes and my failures! [Read More](#)