



## Planning for Major Purchases or Expenses

There will be always things you want to buy in addition to your normal living expenses. It may be a new computer, a gift for a special person, some clothes, a nice vacation or something for your home or apartment. All of these things take money and you will be faced with a decision – “should I save until I can afford to pay cash for these things or should I just charge them on a credit card?” In your heart, you know you should probably save and avoid interest costs on your credit card, but the temptation to buy them now can be strong. Let’s take a look at some of the financial factors you should consider.

### Saving and paying cash versus charging on a credit card

- Paying cash for a new \$1,200 computer – save \$100 per month for 12 months and it is paid for.
- Buying a new \$1,200 computer with a credit card (15% interest rate) – It will take over 13 months of \$100 payments to pay for the computer and the interest costs. Over that period you will pay \$108 in interest.
- Taking a seven day vacation (7 days at \$350 per day plus 2 plane tickets at \$350 each) with a total cost of \$3,150 – save \$200 per month and you will have the \$3,150 in less than 16 months.
- If you charge that same vacation and pay the same \$200 per month, it will take just under 18 months to pay the additional \$380 in interest you will be charged.

The point is not that you should never charge things on your credit card, but rather you should understand that paying interest can be expensive. For example, if you use your credit card for that \$3,150 vacation and only pay \$150 per month instead of \$200, it will take you 25 months to pay it off and you pay over \$525 in interest.

### Accumulating funds to buy a car

Saving funds for a down payment for a car takes discipline, but there are some ways to save to make it easier.

Let us assume you want to buy a new car that costs \$25,000. Let us further assume that you want to limit your monthly auto loan payments to \$400 (48 month loan of \$17,000 with a 6% interest rate). If you do the math, you will find that you would need a down payment of about \$8,000. How can you accumulate the \$8,000 you need?

Start by setting up an automatic savings plan at your financial institution. That way, each month a predetermined amount will be transferred into your savings account. When you have saved the \$8000, you can then buy the car you want knowing you can afford the \$400 monthly payments.

### How long does it take to save \$8,000?

| Savings period | Monthly savings |
|----------------|-----------------|
| 12 months      | \$658           |
| 18 months      | \$435           |
| 24 months      | \$324           |

### Other options

Choose a less expensive car. If we keep the same \$400 monthly loan payments, but choose a \$20,000 car, you will only need a down payment of \$3,000. That will take less than half the time to accumulate.

Choose a 60 month auto loan instead of one with 48 months. Again, we will keep the monthly payments at \$400 and a 6% rate. Under these assumptions, your loan would be about \$21,000 and you only need a down payment of \$4400.

**Loan payment table**

| <b>Loan amount</b> | <b>Monthly payments with a 48 month loan 6% interest (total interest)</b> | <b>Monthly payments with a 60 month loan 6% interest (total interest)</b> |
|--------------------|---|---|
| \$10,000           | \$234.85 (1272.82)  | \$193.33 (1599.68)  |
| \$15,000           | \$352.28 (1909.22)  | \$289.99 (2399.58)  |
| \$20,000           | \$469.70 (2545.66)  | \$386.66 (3199.35)  |

### Buying a home

Figuring out how expensive of a house you can afford will largely be dependent on the level of your monthly payments. There will be property taxes, insurance and upkeep, but your monthly payments will probably be the most important part of your decision.

The fine line you walk when determining a level of down payment is based on the level of mortgage payments you can afford and how much money you have for the down payment. Mortgage rates are constantly changing and there are all different types of mortgages available.

### Estimating your mortgage payments

Here is a chart showing monthly payment levels for different amounts at different interest rates.

It reflects using a 30-year fixed mortgage. Payments with a 15-year mortgage will be higher, but you will pay off the mortgage sooner and pay much less interest over the life of the mortgage.

| <b>Monthly Mortgage Payments at different interest rates<br/>(30-year fixed rate mortgage)</b> |             |           |             |           |             |           |
|--|-------------|-----------|-------------|-----------|-------------|-----------|
| <b>Mortgage amounts</b>  | <b>5.5%</b> | <b>6%</b> | <b>6.5%</b> | <b>7%</b> | <b>7.5%</b> | <b>8%</b> |
| \$ 50,000  | 283.89      | 299.78    | 316.03      | 332.65    | 349.61      | 366.88    |
| \$ 75,000  | 425.84      | 449.66    | 474.05      | 498.98    | 524.41      | 550.32    |
| \$100,000  | 567.79      | 599.55    | 632.07      | 665.30    | 699.21      | 733.76    |
| \$150,000  | 851.68      | 899.33    | 948.10      | 997.95    | 1,048.82    | 1,100.65  |
| \$200,000  | 1,135.58    | 1,199.10  | 1,264.14    | 1,330.60  | 1,398.43    | 1,467.53  |

If you are looking at mortgages of different levels, you can use the chart to estimate or use a mortgage payment calculator on the Internet.

### Accumulating a down payment

Most lenders require certain levels of down payments to consider you for a mortgage. It often ranges from 5% to 25% of the purchase price. The larger the down payment, the more comfortable they will probably be giving you the mortgage. You should also remember that it may be nice to have some extra money available after you move into your new home. New carpeting, new furniture or improving the landscaping all take money. You should not stretch yourself too thin financially.

### **Here are some ways to consider to build funds for the down payment.**

- Save. As simple as it sounds, most people end up saving for a couple of years to accumulate the amount needed. This may mean less or cheaper entertainment or less dining out. One easy way to save is to enroll for an automatic savings plan at your financial institution. Have a certain amount transferred from your checking account to a dedicated savings account each month. This provides some discipline and you may be able to use a money market type of account to earn higher interest.
- Borrow the down payment from your retirement plan. Many company-sponsored 401(k) or profit sharing plans have provisions to let you do this. Check the details of your plan. The Human Resources or Payroll department can help.
- Move. Living in a cheaper apartment while you accumulate your down payment can help you get your money faster. Cheaper rent may balance off a longer commute to your job. If you are just starting out or are considering changing jobs, you may want to consider an area that has lower costs of living.
- Reduce other high interest rate debt. Paying off credit cards will take some of your savings, but you will not be paying the high rates usually found with credit cards.
- Make a deal with the seller. Sometimes a seller is willing to help sell their home by taking a second mortgage for part of the purchase price. Be careful if you are considering this and make sure a qualified attorney looks at all the documents.
- Sell some of your investments.
- Get a second job and save your earnings.
- Skip a year's vacation.
- Borrow from your parents. Many parents are willing, or even anxious, to help their children with the purchase of a first home. Be respectful of their generosity.

### **Conclusion**

Buying a home, especially a first home, is a big financial and emotional step. If buying a home is important to you, do your financial homework. Investigate your mortgage options. Determine what level of monthly mortgage payments will be affordable and comfortable. Use some discipline to save your down payment.