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YOUR WEALTH JOURNEY — NAVIGATING LIFE'S FINANCIAL MILESTONES

Financial Tips for Making a Major Purchase

Address these financial considerations when purchasing a new vehicle or home

When it comes to making a major purchase—such as buying a new vehicle or investing in a second home—you want to take your finances into consideration. From a budgeting perspective to how the cost will impact your long-term financial stability, there is a lot to think about. We have five tips to help you make that next big purchase.

Review Your Budget

What are your monthly expenses? How much are you putting into savings each month? The 50/30/20 rule is an easy budgeting strategy that can help you manage your money effectively. It means spending 50% of your income on needs (think monthly expenses, such as housing, utilities, insurance, childcare, etc.), spending 30% on wants (such as a luxury car or vacation home), and putting 20% in savings.

Before you make a major purchase, review your budget to determine how your purchase will affect your lifestyle spending and ability to save. You do not want a short-term purchase to affect your retirement goals. Make sure you are able to maintain retirement plan contributions after making the purchase. And if you plan to use emergency reserves to cover the cost, consider how long it will be before you can replenish that money.

Know the True Cost

When making a major purchase, you need to determine the true cost of the item. That means accounting for the actual price along with any ongoing expenses. There are considerable costs that come with buying a second home or a luxury vehicle, and not budgeting for expenses can impact your long-term financial stability. For example:

- When purchasing a new vehicle, you will have to cover the cost of repairs, maintenance, insurance, licensing, and registration. Maintenance of a domestic car can be a fraction of what it is on a high-end luxury car.
- Buying a house comes with the added expenses of utilities, property taxes, insurance, repairs, and maintenance. If you are purchasing a vacation home, think about not just where property taxes are today, but where they will likely be in 10 years.

Determine Timing of Purchase

The more time you have to plan for a big purchase, the more time you have to do it in an efficient manner. For example, if you are going to liquidate some of your portfolio rather than assume more debt, you may be able to extend the capital gains, and taxes associated with those gains, over several years.

In the case of purchasing a home that you will use as your primary residence, align your mortgage or long-term debt obligations with the time you plan to be employed and bringing in an income. It's probably not ideal to take out a mortgage at age 70 and have only your retirement funds available to pay it off.

Funding the Purchase

Decide whether you plan to use existing cash you have accumulated or debt to make the purchase. This is largely a question of risk tolerance. Using cash is a more conservative approach, while loans carry risk since you are taking on debt burden. When purchasing a primary residence, you may want to be a little more aggressive, as this falls into the "need" category of your budget rather than the "want." As for a second home, make sure not to overextend yourself.

When it comes to taking on debt to make the purchase, there is a lot to consider. You will want to understand the terms (interest rate, amortization period, fixed versus variable rate, monthly payment) you can expect based on the type of loan and the total interest you will be paying over the life of the loan. Options to consider include:

Home equity loans:

Home equity loans often carry a considerable amount of refinance costs and upfront costs. However, this offers you the opportunity to get a fixed rate, so you are locked in at a lower rate over a long period.

Cash-out refinancing:

This may give you the opportunity to decrease your monthly payment or negotiate a lower interest rate; however, make sure to consider the added costs and fees associated with refinancing.

Personal loan from bank:

While interest rates and fees associated with personal loans may be higher than other lending options, you may find that banks offer more flexibility and higher borrowing limits.

Margin loan:
If you are making a short-term purchase, margin loans come with no upfront costs and can bridge a gap for longer-term debt. Margin loan rates are not fixed, so remember that they will fluctuate and could increase.

Financing options offered by seller (i.e., dealership financing):
If you are purchasing a vehicle, you might have an opportunity to get 0% financing for a specified number of years, which is appealing because it gives you time to produce the funds you need and to generate the liquidity in a more efficient manner.

Long-Term Financial Goals

Major purchases can threaten your financial goals if you do not prioritize appropriately. Your initial focus should be on emergency funds and retirement funds, which are high priorities that you don't want to compromise for a major purchase.

In addition, rather than focusing solely on how you are going to pay for the purchase now, also consider how it will affect your long-term goals, such as retiring at a certain age or having a sufficient nest egg built to live the retirement lifestyle you worked hard to afford. While it may be easy to recognize the initial impact on your finances—namely purchase price and increased ongoing expenses—it's generally more challenging to assess the longer-term financial implications of a major purchase.

It's often helpful to work with a wealth advisor who can run a holistic financial plan to help quantify the long-term impact and ensure you're not compromising your long-term financial stability and goals.

Contact Us:

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