

THE IMPACT YOUR CAR HAS ON YOUR FINANCIAL FUTURE !

A Typical Cost Breakdown

So, just how much is that car costing you? Let's take a look at a typical vehicle and scenario that would fit almost any middle class American household. We're going to use a new Toyota Camry and these sell for anywhere from about \$20,000 – \$30,000 depending on features and your location. So, we'll shoot for something right in the middle of the pack and assume for this example that someone finds one for \$25,000. And let's not forget about sales tax since that's going to apply to most people as well. 6% is a fairly common state sales tax rate so if we tack that on to the price of the car we have a total sale price of \$26,500.

It really doesn't matter what kind of car we're talking about or even whether it's new or used. What's important is the actual price paid.

Financing

Now let's talk financing. Most people don't pay cash for their new car and will typically finance it for somewhere between 3 and 5 years. In addition, most people don't put a significant down payment down or will trade in their old car. For the sake of this example we'll assume that we're putting \$5,000 down or getting \$5,000 for a trade. That means we're left financing \$21,500, and let's shoot for a 48 month loan. Rates on this type of loan right now are averaging around 7% so we'll go with that. That ends up adding \$3,200 in interest payments over the life of the loan and a **monthly payment of about \$512**.

Insurance

Insurance is going to vary depending on a lot of different factors. The deductible you choose, your driving record, age, state, and so on. So the best we can do is ballpark an average rate for this type of car. Just keep in mind that you may be paying quite a bit more or even less depending on your situation. Running some quotes and looking online the annual insurance premium on about a \$25,000 sedan will cost roughly **\$1,200 a year or \$100 a month**.

Gasoline

Every car needs gas, and gas can be expensive. Luckily for this example we have a car that gets decent gas mileage and it's rated for roughly 20 mpg city and 31 mpg highway. We'll average it out and assume an overall mpg of 25. The average person drives 12,000 miles each year. Obviously, your own driving habits may differ. But at \$3.00 a gallon that would mean you spend **\$1,440 a year or \$120 a month** on gas.

Maintenance

Cars need a little TLC and you will need to spend a little money to keep it running its best. The most common maintenance item is the oil change. At a quick lube place you can expect to pay around \$30 for an oil change and you'll likely need 3 of them a year. You'll also probably need a few other odds and ends like new wiper blades, car washes, etc. So we'll allocate another \$50 a year to cover those miscellaneous expenses. Regular maintenance costs are going to be around \$140 a year and you can probably expect to pay about \$100 or so on annual vehicle registration. Just to keep things simple, we'll call these miscellaneous expenses **\$20 a month**.

Total Monthly Breakdown:

- Car Payment = \$512
- Insurance = \$100
- Gas = \$120
- Maintenance = \$20
- **Total = \$752**

It's amazing how fast that adds up, isn't it? We're talking \$750 a month just to drive a middle of the road sedan. And that's with a 20% down payment, a good credit score that gets you a decent interest rate, and a clean driving record that keeps your insurance premiums down. Just imagine if you can't get a rate for 7%, don't put any money down, or your insurance premiums are nearly double because of a few tickets on your driving record. You could easily be approaching \$1,000 a month. If you earn \$40,000 a year you're spending nearly 25% of your **gross** income on a vehicle that only decreases in value each year that you own it.

Multiple Vehicles and Luxury Cars

In that example we just used a modest no-frills sedan and look at the true cost with that. Now, think about needing two of these cars because you're married and you both work. Now you're making a mortgage size payment just to have something to drive you around.

And what if you're driving a luxury car or SUV that comes in at \$40,000 or more? You can expect your total monthly costs for just one car to easily exceed \$1,200. If you need two of these more expensive vehicles you better be prepared to shell out close to \$3,000 a month.

Car Costs vs. Saving

I help people with their finances every day. That's my job. That means I usually have to spend some time digging into a person's finances to help uncover problem areas or opportunities. If there is one thing that I see more than anything, it's people who are spending more on their vehicles than what they are saving for retirement or otherwise.

Without fail, whenever someone says they don't have any extra money to put into their retirement account or into a savings account, you can almost always count on significant car costs when digging through their monthly expenses. Whether it's \$300 a month or \$700 a month, they can make those payments each month yet can't scrape together \$100 to put into a savings account or their retirement account.

Here's a rule of thumb: **if your total car costs exceed what you're able to save, you have more vehicle than you can afford.** That means if you're paying \$500 a month to keep your car on the road yet can't come up with \$500 each month to stick in your savings or retirement account, you're in trouble. You will never build the wealth you want by throwing more money away on a vehicle than you can save or invest. That money you apply to a car payment, gas, insurance and everything else doesn't come back. You do not make money and it is not an investment.

At the same time if you can afford to spend \$1,000 a month on your vehicle and still save \$1,000 a month, that's great. Sure, you could still save more money if you cut down your car costs, but at least you are matching every dollar that goes out and putting it into something that is an asset and an investment. At the bare minimum that is how you need to look at it. You have to at least be saving as much as you're spending.

How to Make Sure Your Car Doesn't Make You Poor

As you can see a car can make you poor pretty fast. The costs add up and if you're spending more money on a mode of transportation than what you're setting aside for the future it's going to take a long time to build wealth. Unfortunately, most of us need a car. That's just the reality of it all. But you can take some steps to make sure that you're keeping your car costs as low as possible so that you can focus on building wealth, not just maintaining a vehicle year after year.

Used vs. New

It goes without saying, but a used car is going to save you money. Remember, cars depreciate in value, often as much as 20% each year. If you can buy a used car even just a year old you could save thousands of dollars which translates to less interest when financing and a lower monthly payment.

If you are looking at a new car, that's fine too as long as you plan on owning the car for a long time. When you get into trouble is when you keep buying a new car every 3 or 4 years without paying off the first one, or just barely paying it off before buying a new one. This creates a vicious cycle of constantly spending more than you need to. A new car can be a good deal if you know that you're going to keep it well beyond the financing terms.

Size Matters

The larger the vehicle, the more it costs. Smaller cars are generally cheaper than full size cars, and cars are usually cheaper than trucks or SUVs. So, only buy as much car as you

really need. Your situation and driving needs will dictate what kind of vehicle you need, but don't go overboard.

As you increase in vehicle size and price, you'll also typically get increased insurance premiums and fewer miles per gallon as well. So, there is more to size than just the initial cost. The higher costs often trickle down to all other areas and it will really start to add up fast.

Consider Depreciation and Maintenance

Not all vehicles are created equal. Some cars will hold their value over time better than others, and some cars have notorious maintenance issues. Do your research before buying your next car and don't just buy something because it looks good in the commercials. You can not only save some headaches down the road by picking a reliable car, but if it retains its value you will take less of a hit when it comes time to sell.

Finance Wisely

If you need to finance your car purchase, be smart about it. Yes, you can keep your monthly payment low by stretching out the loan to 5 or 6 years, but you aren't doing yourself any favors. All you're doing is paying more interest on something that continues to decline in value. Would you borrow money at 7% interest just so you could invest it in a stock that was guaranteed to drop in value by 15% each year? Of course not, but that's what you're doing when you finance a car purchase. We know that the value of the car is going to go down each year, so the sooner you can pay it off and the less interest you pay, the more you ultimately save.

You Are in the Driver's Seat

It's up to you to decide how you want to spend your money. A vehicle may be a necessity, but it doesn't have to negatively impact your financial future. If you aren't careful, a vehicle can erode your wealth faster than anything else, but with some smart decisions you can make sure that it doesn't.

Be smart about your vehicle costs. It might be nice to drive around in something a little fancy but is it worth the negative impact it may have on your long-term financial goals? It's your choice !