THE Wealth REPORT

# STRATEGIES FOR BIG-TICKET PURCHASES

Is there a way to get all the things we want in life without jeopardizing our long-term financial security? With limited resources, it can be difficult to save for a variety of big-ticket expenses, such as a house, college education for our children and retirement somewhere down the road. Along the way, how do we prevent the purchase of a new car or a memorable vacation from derailing our goals?

## Overview

Two roads diverge when we become adults, and the path we choose is frequently influenced by the opinions and lessons of our parents. When it comes to saving and financial security, do you start right away or take a bit of time to enjoy yourself?

That's one of the factors considered by students who take a "gap year" before or just after college — before getting "a real job." In fact, some seasoned parents will advise their children to go ahead and enjoy their financial freedom while they're young before getting tied down to the responsibilities of a mortgage and raising a family.

However, just because young adults want to live a little doesn't mean they don't eventually want to own a house or start a family. By the same token, midcareer professionals and families with children who juggle a mortgage, education expenses, vacations, automobiles, braces, summer camps and other expenses know that each financial decision could impact their lifestyle during retirement. It's a constant battle to decide where and how much money we can spend without jeopardizing our long-term goals.

The key is to balance a saving and spending strategy that allows for a satisfactory standard of living today without sacrificing our lifestyle tomorrow.

## Automatic Saving

One time-tested strategy is to use a household budget. By tracking the money that comes in and goes out of the household, it is possible to develop a budget that covers expenses while allowing for entertainment and a few luxuries — without compromising the future.

An important tactic is to make saving and investing a line item in the household budget. Financial advisors often refer to this tactic as "paying yourself first." In other words, allocating money for saving should be considered just as important and automatic as paying your car loan and electric bill.

There are two roads that diverge here as well. Some people pay all the necessary bills and save whatever they have left. Unfortunately, a lot of discretionary expenses tend to creep into that regular household budget, frequently leaving little to no money for saving. The second road is to make saving and investing part of those necessary expenses, leaving any leftover money available for discretionary spending.

# Compartmentalize

A second strategy is to compartmentalize savings goals. For example, if you participate in a company 401(k) or other employer-sponsored plan, then money is drafted from your paycheck and invested before it even hits your checking account. This is the most efficient and effective way to save for retirement.

However, most people have other big-ticket things they want in addition to retirement savings. One tactic is to create separate accounts earmarked for those goals rather than throw all leftover savings into one account. A key reason for this is that it helps measure progress toward a specific goal, which can be very motivating.

The opposite is true of a catch-all savings account. That's because this account will rise and fall based on a variety of expenses you must pay throughout the year, such as annual property taxes, auto and homeowners insurance, homeowners association fees, home maintenance and repair, vacations or cash for an emergency.

It is a good idea to maintain a catch-all savings account for these types of one-off expenses. However, if you have a specific goal in mind — such as a new car — consider opening a separate account and contributing to it regularly. Even if you need to stop contributing for a month or two to pay other expenses, that's OK. It is psychologically comforting to know that you don't have to deplete this account to pay regular expenses. Eventually, you'll meet your financial goal and can purchase the item without sacrificing short- or long-term financial obligations.

***Due Diligence***

Another tip is to plan and research while you save, so that once you have the funds, you know exactly what to buy. This can help you determine the true expense of that item. For example, if your goal is to buy a boat, consider where you will keep it. If you keep it in your driveway, will your homeowners association object? If you rent a marina slip, what will be the ongoing cost? What expenses are involved in gas, maintenance and upkeep?

It's important to know all of the ancillary costs involved now and in the future before you make a big purchase. Not only does this due diligence help you get the most value from your big-ticket item, but it also provides a high level of confidence in making the right decision and a strong feeling of satisfaction for having saved for it.

***Saving For "Come-What-May"***

Another part of the compartmentalization strategy is to save regularly in a savings account for unexpected expenses. Even if you don't have a specific goal, that money creates a safety net for unknowns and emergencies, such as a new roof or car repair. Consider keeping at least $1,000 or $2,000 in this account so you can cover these unexpected needs without running up a credit card balance or siphoning money from other accounts.

# Equity Builder

As a general rule, some purchases increase in value while others decline. Therefore, consider whether your big-ticket purchase will be an asset or liability. For example, your mortgage and your auto loan may both fall into the high-debt, liability column. However, houses generally increase in value over time while cars decrease.

When making a large purchase, consider whether it has the potential to offer a return on your investment. Second, consider whether it will replace a current cost. For example, buying a home may cost more, but it will replace the cost of renting. Buying a new or at least newer car may replace the cost of one that is paid off but generates ongoing repair bills. In both cases, the new purchase may build equity or at least forestall higher expenses in the future.

On the other hand, a vacation doesn't replace costs — it adds to it. In some cases, however, a little outside-the-box thinking can help counteract additional expenses. For example, if a couple in Minnesota want to spend half the year in Florida, perhaps they can offset that expense by renting out their home while they're away.

***Investing***

Using invested funds to pay for high-ticket purchases can be tricky. Investors may want to work with an experienced advisor to determine whether withdrawals will trigger capital gains, income taxes or an early withdrawal penalty. It's also important to consider whether depleting that account would unduly sacrifice potential gains and/or derail the potential for long-term financial security.

Bear in mind that investment accounts specifically designed for a certain goal, such as a 529 college savings account or IRA, generally have barriers intended to deter the investor from using those funds for any other purpose. Some may provide exceptions, however, such as waiving an early withdrawal penalty for a qualified first-time homebuyer.[1]

Consult with your advisor on the most suitable way to fund a large-ticket item to help you evaluate the pros and cons of each available option.

***Potential Funding Sources***

- Bank savings account
- Certificate of deposit
- Securities or mutual funds
- Traditional IRA
- Roth IRA
- 401(k) loan
- Life insurance cash value account
- Annuity withdrawal
- Credit card
- Home equity
- Sell an item of value
- Part-time job


*"Generally, early distributions are those you receive from an IRA before reaching age 59 ½. The additional 10 percent tax applies to the part of the distribution that you have to include in gross income. It's in addition to any regular income tax on that amount."*[2]

## Lifestyle Should Fit Income

Probably the most significant strategy for making an expensive purchase is to determine whether you can afford it. This is not as simple as it may appear. In other words, your income may justify a higher expense than normal — but does your lifestyle?

For example, perhaps you can afford to buy an expensive foreign sports car. However, consider that it may be costly to insure, maintain and repair. Furthermore, does it reflect your values? If you've taken pains to live within your means in terms of your housing and other choices, perhaps it is more prudent to buy a car aligned with the rest of your lifestyle choices and save what you might have otherwise spent.

While it's great to aspire to a higher income, our lifestyle should fit our current income. If we can learn to be content with what we have, any additional funds are a bonus. There are few negative consequences to living below our means but quite a few advantages. One, of course, is that we have money available for those periodic big-ticket items without disrupting long-term plans for financial security.

## Final Thoughts

When you consider making a high-expense purchase beyond the usual household budget, differentiate between a predetermined goal and an impulse. This distinction may force you to weigh, for example, whether your sudden desire to buy a boat after a fun-filled week at a friend's lake house is worth derailing your plans to buy a house in two years.

Even when you establish a specific financial goal worth saving for, remember that you also must address your sequence of priorities. Establishing an order for which goals are most important can be very helpful when it comes time to make a decision about whether (and when) to make an expensive purchase.

We've always known that patience is a virtue. But we may not always recognize that it is a financial virtue, as well.

[1] IRS. Sept. 11, 2017. "Topic Number: 557 - Additional Tax on Early Distributions from Traditional and Roth IRAs." https://www.irs.gov/taxtopics/tc557. Accessed Dec. 13, 2017.
[2] Ibid.