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BUYING CARS WITH CASH AND THE COST OF CAR OWNERSHIP

Everyone - me included - loves a new car. Teenagers, especially 16 year olds, dream of buying a new car or any car. They will save a little and borrow the rest to buy that first car. It is not just teenagers but most everyone that borrows to buy a car. As a retired banker, I can appreciate the opportunity to loan money on a car, new or used. That is the way lending institutions make money - by loaning it out. However, wearing my financial planner hat, I can tell you that borrowing money to buy a car is not the advice I give in my financial seminars. Here are the reasons why I suggest buying a car with cash.

First, cars are the single biggest consumer purchase most people will make that doesn't hold its value. A home is a bigger consumer purchase, but generally homes appreciate over the long haul by 3% to 4% per year (even with the recent bubble in house prices that sent housing prices tumbling 33% from peak to trough nationwide). Other consumer items like clothes and appliances, etc., depreciate in value as do cars, but cars are more expensive than these other depreciating items. The average new car cost $28,000 and deprecates $17,000 in the first four years according to statistics I have read. Each year, the average car will continue to depreciate further.

I have a presentation and a companion book I give to students about the importance of saving and the power of compound interest titled "Making a Million with Only $2000 - Every Young Person Can Do It." In this presentation and book, I explain that $2000 saved and invested can compound to $1,000,000 in about 54 years, given the historical compound rate of stocks at the time the book was written (slightly lower now but not by much). I tell students that they need a safe reliable car, and I talk to them about lowering their odds dramatically of not being a fatality statistic (by never drinking and driving, always wearing their seatbelts, paying attention, never driving too fast, and never riding with someone that doesn't do all of the previously mentioned items). But I tell them that if they were to buy a safe and reliable car that is less expensive than a safe and reliable fancy car, it can save them $10,000, given the same 54 years that $10,000 saved can compound to $5 million. In fact, the average car payment is nearly $500 per month. If that car payment were saved and invested at the historical return of stocks, it could grow to $24 million in the same 54 years. That is the power of compounding.

In my banking career, I've known many people (most) who make car payments their entire lives, paying interest each month. Just about the time they pay off the car, they start over and borrow again and buy another. With a two-car family, two $500 monthly payments is $1000 per month out of a budget which is a great deal.

What I recommend that most people do not want to hear is to make a payment to themselves of $500 or whatever instead of a car payment to a financial institution. In the process that person is saving up to pay cash and saving the interest on the loan. When a person has saved enough to pay cash, then he can buy the car. Most people tell me this seems impossible. Here is my example. Let's say a person has a car valued at $2000 (a "junker" that runs but will need to be replaced at some point). Rather than borrowing to buy a new car and paying $500 per month, that person can make a payment to himself each month of $500. At the end of the year, that person would have $6000 saved and could buy an $8000 car ($6000 cash and $2000 trade-in). If the person wants to buy a higher priced car, my answer is to save for a longer period. Two years saving $500 per month would allow a person to purchase a $14,000 car. This can be done by purchasing the $8000 car after one year and then trading up again with another $6000 saved or just saving for two years. I believe this technique makes sense because it means you never buy more of a car than you can afford because you don't buy until you have saved the money.

As mentioned, I am not against cars; and, in fact like them as much as the next person. In my seminars to students I tell them not to overpay for a car early in life so they can save and accumulate money so that ultimately they can buy a car out of the interest earned on their principal without every spending from the principal. That is the goal of saving for the future which I call "making money work for you." As I tell students, if they have saved and invested and accumulated enough, they could buy a new car out of the interest every year if they want. (This is not necessary, obviously, but they could.)

As a sidebar on cars, AAA just came out with its annual driving costs survey. According to their studies, motorists will pay $8,946 to operate their cars this year. This equates to 59.6 cents per mile based on driving 15,000 miles per year. Operating costs, or variable costs, are 19.64 cents per mile which includes gas at 14.17 cents, maintenance at 4.47 cents and tires at 1 cent. Fixed costs are nearly 40 cents per mile or $16.44 per day which includes insurance at $1,001 per year, license and taxes at $610 per year, depreciation at $3,544 per year, and finance charges at $846 per year for a total of $6000 per year. (Notice that if a person drives a low-cost car or drives a car for a long time while taking care of it, his annual depreciation could be some less than average. Further, if a person pays cash as I suggest, he would eliminate the finance charges.)

If you use my plan to pay for cars with cash, you will be in a very small minority who do not borrow to buy cars, which could also put you in small group of wealthy individuals down the road.

(Remember every investor's situation is unique, and it is important to review your specific situation with a financial professional.)

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