I Want it All and I Want it Now

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The neighbors have a shiny new sport utility vehicle to tow their travel trailer. They take a two-week tropical vacation every winter. Their family room is equipped with the latest large screen TV and surround sound stereo system. Many people believe this is a sign of wealth. In fact, this is usually a sign of consumption.

More often than not, the above lifestyle is funded with huge amounts of debt.

Fewer and fewer car ads list actual vehicle prices. Instead, they advertise supposedly low monthly payments. Often these payments are for a lease based on a minimal annual usage. If the vehicle is driven more, then the monthly lease payment will be higher.

Lenders have made it easier for borrowers to access the equity in their homes to fund lifestyle expenses. Many merchants offer financing on larger purchases, and some may even defer payments for many months, even years. Make no mistake; these purchases will eventually have to be paid for.

Many consumers today forget that they must make their purchases with after-tax dollars. For example, a $700, taxes-included monthly vehicle lease payment will require $1,076.92 of earned income for someone in a 35% tax bracket. This four-year lease will gobble up $51,692.12 of employment earnings.

Using a credit card to finance a consumer purchase can be extremely expensive. For example, a $5,000 purchase financed for three years at a typical credit card interest rate of 18.8% would total $6,579.72 in payments. Using the same 35% tax bracket, **it would take $10,122.65 of employment income to pay for the $5,000 item**.

Consider that the more things you have, the more time and money it will cost to manage them. We have all seen the self storage facilities dotting our landscape. RV storage yards take up dozens of acres around our communities. Don’t forget to factor in the monthly storage fees – paid for with after-tax dollars – to the cost of ownership. A $200 a month storage fee may cost more than $300 a month in earnings.

Do without the nicer things in life? Of course not. We can, however, take a lesson from the rich on how to pay for some of our lifestyle expenses. **There are two types of debt: good debt and bad debt**. Good debt supports an asset and bad debt supports a gratification. The rich further define an asset as something that generates an income. Banks may define your house, a vehicle or recreational vehicle as an asset because that’s where they make their income if you have financed it.

Another strategy the rich use is saving employment income, investing for growth & income and delaying gratification purchases until the investment income is sufficient to cover their costs.

Tom and Claudette decided to use this approach for their lifestyle expenses. They borrowed $25,000*, deposited it in an investment fund and **paid the loan back over three years**. Because the money was borrowed to invest, any interest they paid was a tax-deductible expense.

After the loan is paid in full, assuming a 7% withdrawal rate, they now have $1750 of gross annual investment income. If the full $1750 was taxed as a capital gain and assuming a 35% tax bracket again, they would have **$1443.75 to spend as they wished**. If they used employment income, they would only have $1137.50 after taxes.

Tom and Claudette also made **regular monthly deposits to their investment fund account to further increase their future lifestyle income**.

Call us today [1] if you want help with your financial independence planning.

**Fictional characters for illustrative purposes only.*

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