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Focus on the NEXT GENERATION
JUNE 2011

Budget Busting Blunders

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We have all made small financial mistakes before. Impulse buys at the grocery store. Stopping at the closest gas station only to see one across the street is five cents a gallon cheaper. Forgetting the $10 gift certificate for the restaurant, knowing it expires tomorrow. Most times, these are mere inconveniences, and we move on with our lives.

Other poor financial decisions are not so forgiving. Making these kinds of mistakes can cost significant amounts of money and creates debt that takes years to dig out from under.

Here are five "blunders" that can cause havoc with your finances. Stay away from them if you can, but if you find yourself already in the middle of one, don't worry – we also give some suggestions of how to get out of them.

Inadequate property and casualty insurance. It always surprises me that the more common some things are, the less people pay attention to them. Everyone has home and auto insurance, yet so few people know what their deductible is, much less what their coverage will actually pay for. For example:

- If you finance a new car, and get in an accident 9 months from now, will the insurance check cover the loan?
- If your sump pump goes out, will your homeowner's policy pay to repair your newly refinished basement? If so, is there a dollar cap (i.e. $10,000)?
- If your college student gets into a fight outside a campus bar and gets sued, will your umbrella policy cover the attorney's fees?

Solution – Review your insurance policy today and every 2 years. Shop around and get quotes from at least 3 different companies. Always pick your agent's brain about coverage amounts, potential gaps in coverage and discounts.

Addiction to plastic. There seems to be a large portion of Americans that like to shop. At least that's what I assume when I hear that the average credit card balance is over $8,000. Of those that carry a balance, the average household credit card debt is over $14,000. Based on the average interest rate on balances of 13.44%, that means that these households are paying roughly $1,800 or $150 per month in interest per year.

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Budget Busting Blunders *(continued)*

Also remember that unlike mortgage interest, credit card and other consumer debt interest is not tax deductible. That means the average household has to earn $200 more just to have enough to pay the $50 tax on that money and make the $150 interest payment.

Here are some other shocking statistics from creditcards.com:

- Total U.S. revolving debt (98% credit card debt) is $796.1 Billion, roughly $2,650 for every man, woman and child in America.
- Total U.S. consumer debt is $2.43 Trillion, roughly $8,100 for every American.
- Three-quarters of college students have one or more credit cards, and their average balance is over $2,000 in credit card debt.

Solution – Don't use a credit card unless you already have the money in your checking or savings account. If you already have a balance, always pay more than the minimum and look for ways to limit the use of your card until the balance is paid off. Most importantly, teach your children how to use credit – when it is OK to go into debt and when it is not.

Buying a new car. There is an old adage; the most expense smell in the world is not a perfume, it's the smell of a new car. According to AAA, the average car costs over $8,750 per year to own and operate. However, newer cars have much higher average costs because of one thing: depreciation.

Here is Edmunds.com's breakdown of the typical new car depreciation:

- New Car Cost - $29,873
- After 1 Minute - $27,314 (you lose $2,559)
- After 1 Year - $24,186 (you lose $5,687)
- After 3 Years - $17,406 (you lose $12,467)
- After 5 Years - $12,069 (you lose $17,804)

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Solution – Buy a "New to You" car, also known as a used car. Domestic, smaller and less popular models will have the most depreciation, so when looking for a used car, these are great places to start. A 3 year old car can cost half as much as a brand new car, and should still have years of life left in it.

Financing an average college education. College costs are bad enough ($16,000 in-state, $37,000 private), but having to pay interest on college loans turns bad into worse. There was a recent article on a couple who had $500,000 in college loans, yet they were only making $80,000 per year. Even if they were both paying the subsidized Stafford loan rate (currently 3.4%), the interest alone works out to $17,000 per year, or over 21% of their gross income. Ouch.

The best idea is to plan ahead, and avoid getting into this situation in the first place. There are several ways to do this:

- Go to a community college for 2 years and then transfer. Community colleges average about $3,000 per year and by living at home and commuting, you can save even more on room & board.
- Shop around for the best financial aid. Different schools have different criteria for their aid, and if a school wants to admit your son or daughter, they will do what they can to enrich the financial aid package.
- When in high school, take dual credit courses. These are classes offered by or in conjunction with local colleges and universities that qualify for both high school and college credits. They are also very reasonably priced; $50 - $75 per credit hour vs. over $200 per credit hour at the in-state public school and $1,000 or more per credit hour at private schools. Just 15 credit hours is an entire semester, saving you thousands of dollars. AP courses and CLEP exams also help.

Already have college loans? **Solution** – Pay them off as soon as possible. Use the current low interest rates to pay college loans down faster, not to stretch out the payments. Focus on the highest interest rates first, and consolidate if it can reduce your overall interest expense. Remember that college debt is still debt, and not even bankruptcy can eliminate them.

Stretching to buy a home. A home is the largest purchase most people make. Due to the sheer size of the purchase, along with all the accompanying upkeep costs, a home can be a financial disaster if purchased or financed incorrectly. For example:

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- Everyone knows the story of the housing market. The decline started in 2007 and is still continuing today. Many people who purchased homes 5 years ago have seen the value of their home decrease by 15% - 30%, and in some hard hit areas it has reached 50%.
- Normally a 10% drop in housing prices wouldn't be the end of the world. The problem is that many people only put 5% or less down when they bought their home. It is now estimated that as many as 1 in 3 homeowners are underwater – they owe more on their home than it's worth.
- Variable rate financing may also be a problem in the future. It sounds great to get a lower initial interest rate, but when interest rates start to go back up (it's only a matter of time), monthly payments that were affordable will quickly become unaffordable.

Solution – Only buy the house that you can easily afford today. Don't depend on overtime pay, bonuses or promotions to make the mortgage payment. If one or more of those things come through, great; bank the money and buy a bigger house in the future.

Michael Kalscheur, CFP®, is a Senior Financial Consultant at Castle Wealth Advisors, LLC. Castle specializes in helping wealthy families and closely-held business owners with strategies to protect and transition family assets from one generation to the next. Castle's senior partners also work with clients throughout the country in making logical decisions to help them fulfill their personal and business financial goals. For more information visit www.castle3.com, call 1-888-849-9559 or contact Michael directly at michael@castle3.com.