

ducation

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Don't Spend Tomorrow's Income Today

From [The Truth About Money](#)

Nobody intends to become debt-ridden, but at some point in your life you may turn around and say, "Gee, how did I accumulate all this debt?" It starts very innocently.

You see, none of us are born in debt. We start life with a clean slate. But then we make bad decisions, or we fall into traps, and the most common trap people fall into is committing themselves to a future lifestyle that is based on their current income.

Here's a great example. Debbie is 23 and lives with her parents. She earns \$23,000 a year. Her parents cover her basic living expenses, although Debbie chips in \$500 every month.

Recently, Debbie's old clunker died and she needed a new car to get to work. She intended to buy a Ford Escort for about \$14,000, but the salesman talked her into buying a hot new Mustang for \$28,000. Well, we can't really blame the salesman -- Debbie loved sitting behind that wheel. And considering her income and expenses, as the salesman showed her, Debbie easily was able to afford the 'stang. So she bought it, financing \$20,000. Her payment is \$445 a month for five years.

By committing herself to this payment for the next five years, she will not be able to move out of her parent's house. Consider the figures: Her after-tax income is about \$17,000, or \$1,400 per month. From this, Debbie has obligated herself to \$445 for the car payment, plus another \$250 per month for insurance, gas, and maintenance -- a total of 50% of her take home pay! That leaves her with only \$805, and that's not enough to rent an apartment and pay for food, clothes, furniture, and utilities -- plus entertainment expenses.

Today, Debbie doesn't mind. But what about three years from now? She has made a decision today that commits her income for the next five years. This not only means she must continue to earn at least as much in the future as she earns today, she must actually increase her earnings if she wants to improve her lifestyle.

And since she has already committed \$595 per month toward her automobile expenses for the next five years, and another \$500 to her parents in lieu of rent, her discretionary income is reduced to just \$305 per month. So guess what happens when she decides to rent a house at the beach for a week with her girlfriends next summer? Debbie runs out of money -- not because she doesn't have any money, but because she has already committed the money she has.

So, to get by, Debbie starts to pay for gasoline with a credit card. When it is time for fall clothes and Christmas shopping, she uses the credit card some more. Soon, she discovers that she's built up thousands of dollars in credit card charges. When the bill arrives each month, she finds herself unable to pay it off because her money already has been spent.

It's very easy to fall into this trap, and newlyweds are caught all the time. My clients Darren and Barbara asked me if they could afford to buy a \$225,000 house, and after reviewing their situation I told them they could, but only if they were willing to become "house poor." They'd have to use all their current savings and investments to get into the house, and then, even after considering both incomes, they'd be stretched each month to pay for the mortgage and related costs. Thus, I told them, they could afford the house if they both continued to work and if their future expenses and income both remained unchanged.

Because I didn't say "no" outright, they were excited. "But," I was quick to remind them, "you don't have children yet."

Too often, I have seen couples experience radical changes when a baby comes. But by purchasing such an expensive home -- by committing such a large amount of their income to maintaining that home -- they essentially were making decisions today that would affect (haunt?) them in the years to come.

Therefore, I advised them to buy a less expensive home, one that did not place such financial restrictions on them for the next 30 years. I cautioned that by doing it their way, in the best case they'd be house poor and in the worst case they'd lose their home. They rejected my

advice. Six years later, after two children, they lost the house and divorced.

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