Don’t Buy Stuff You Can’t Afford

Personal finance and investing writing is generally a pretty dry subject, whether it is a book, an article, or even this blog. There will never be a line stretching around the corner of the bookstore of people camping out for the third volume of a series on investing for retirement. It just isn’t Harry Potter, Star Wars, or Twilight kind of material.

SNL Don’t Buy Stuff

So when something even mildly entertaining on the subject comes along, it might get played and replayed for decades to come. Thus it is with the infamous “Steve Martin Saturday Night Live Don’t Buy Stuff You Cannot Afford” video. Of course, if you’ve never seen it, it’s new to you, so here’s the best link to it. You’ll want to watch this before finishing the rest of this post.

Don’t Buy Stuff You Can’t Afford

The best comedy, of course, is based on reality. It allows us to see ourselves and our silliness from another perspective. My favorite line is “It’s in the book; it’s only one page long.” It’s true though, the difference between wealth and endless poverty is not complicated. Like losing weight, it is simple, but not easy. Nothing has changed since Dickens penned this quote in David Copperfield:

> *My other piece of advice, Copperfield, said Mr. Micawber, you know. Annual income twenty pounds, annual expenditure nineteen six, result happiness. Annual income twenty pounds, annual expenditure twenty ought six, result misery. The blossom is blighted, the leaf is withered, the god of day goes down upon the dreary scene, and in short, you are forever floored. As I am!*

It seems so simple, yet I would venture to say that the majority of Americans, and probably the majority of doctors live with debt hanging over their heads. A Mormon leader said this to his people near the end of The Great Depression, although I suspect many of them had already learned it from personal experience over the previous decade:

> *"Interest never sleeps nor sickens nor dies; it never goes to the hospital; it works on Sundays and holidays; it never takes a vacation; it never visits nor travels; it takes no pleasure; it is never laid off work nor discharged from employment; it never works on reduced hours; it never has short crops nor droughts; it never pays taxes; it buys no food; it wears no clothes; it is unhoused and without home and so has no repairs, no replacements, no shingling, plumbing, painting, or white-washing; it has neither wife, children, father, mother, nor kinfolk to watch over and care for; it has no expense of living; it has neither weddings nor births nor deaths; it has no love, no sympathy; it is as hard and soulless as a granite cliff. Once in debt, interest is your companion every minute of the day and night; you cannot shun it or slip away from it; you cannot dismiss it; it yields neither to entreaties, demands, or orders; and whenever you get in its way or cross its course or fail to meet its demands, it crushes you"*

Many financial columnists and advisers like to talk about good debt and bad debt. While I'll readily admit that some debt is far worse than other debt, I don't really buy into the idea of good debt. But at the same time, you don't want to be so debt-averse that you make stupid mistakes.

I knew far too many military physicians who after long years of training when their pay-pack period arrived, realized they didn't want to be in the military. For many, their aversion to student loans was the major motivator to their military service. It was too late before they realized that they had traded financial loans for time loans, and in the end, it was really the same thing.

Likewise, spending an extra year "saving up" to pay for part of medical school may, in the end, cost the physician a year of attending-level income. Trading $10,000 now for $250,000 in a few years reminds me of Esau selling his birthright for a bowl of porridge. In a similar vein, paying down a 4% mortgage or a 2.9% student loan instead of funding your 401K probably isn't the brightest move either. Moderation in all things.

But far too many of us have adopted society's view that living in debt is normal. As Dave Ramsey says, "Don't be normal!" Let's talk about a few different types of debt and what you can do to minimize the damage that debt does to your financial life.

Don't Buy Stuff You Can't Afford

#1 Mortgages

There are really four key things to do in this area.

1. Most Residents Shouldn't Buy a House

Don't buy a house if you're not financially ready to buy a house. Most students and residents shouldn't be buying houses. Period. 3-5 Years is usually only enough time to break even on it. Despite what you think now, it would be unusual for you to continue living in it on an attending salary even if you stay in the same area, which you probably won't. Plus, you really don't get any significant tax breaks for owning a home until you're an attending. If you don't have 20% of the value of the home saved up, you should really think long and hard about whether you should be renting instead of owning. That would be a very rare medical student/resident, or even a new attending.

2. Don't Buy Too Much House

There's nothing that says doctors have to live in big, nice houses. I mean, you don't want a house where people are getting shot out front, but you don't have to live at the top of Snob Hill either. If your payment with a 15-year fixed-interest mortgage is more than 20% of your salary, you're probably buying too much house. Yes, I know housing costs a lot in Manhattan and San Francisco. Yes, you can probably spend more than 20% without going broke. Yes, it probably isn't the end of the world if you get a 30-year mortgage instead of a 15 year. But realize that the more you spend on housing, the less you'll have for other consumption items or vacations, and the longer you'll have to work until retirement.

3. Get the Right Kind of Mortgage

Usually, if you have a decent income and you didn't get too much house, this part is easy. People usually only have to get creative with their mortgage when they haven't followed the first two points above. 30-year mortgages cost more. Complicated mortgages like interest-only, balloon payments, ARMs etc usually cost more in the long run. Not putting 20% down costs more, no matter what they call that cost. (It can take the form of PMI, higher interest rate, higher closing costs, more points but be assured that cost is there.)

4. Don't Borrow Against Your House

Last, you probably shouldn't borrow against the house. Most of the people who got into trouble in the housing crash were treating their home like an ATM. The best way to ensure you'll be underwater on your mortgage is to put zero down and every time your home appreciates, take that equity out and spend it on a trip to Paris.

#2 Student Loans

Most of us are pretty familiar with this one. Although these loans go away if you die, they, like taxes owed, cannot be discharged in bankruptcy court. The key here is to minimize the damage. If you have some assets, use them for medical school. If your parents, grandparents, or rich uncle can help, accept it and vow to pay it forward later. Spend as little as you possibly can when you're living on borrowed money. Remember that by the time you pay them off, things you buy may really end up costing you two or three times the sticker price.

Try to have a little income through school. It really is possible to hold down a job of some kind through at least three years of medical school. I did H&Ps for a local surgical center. I knew some people who donated to the sperm bank. Others worked at the gym and studied in between customers. Even a little income goes a long way. This isn't the time to have a stay-at-home spouse. Even if you have to watch the kids after school hours so he/she can have an evening job, it'll be worth it. Perhaps try to take out loans only for medical school expenses, not living expenses. Most importantly, go to the least expensive medical school you can get into. I assure you that the education at Boston University is not three times better than the one distilled at the University of Massachusetts. Five years after graduation it will be difficult to find someone who will care where you went to medical school.

Further Reading:

[Ultimate Guide To Student Loan Debt Management For Doctors]

#3 Car Loans

This is a personal pet peeve of mine. I don't understand why someone needs to go into debt to get a car. I have owned quite a few cars in my life. I took out a loan on precisely one of them. The terms were exceptionally good given that the lenders were responsible for my conception. I paid that $3000 back with my 2nd or 3rd paycheck in residency. That is the only car payment I have ever made. Trust me when I say an $8000, or a $5000, or even the $1850 car I drove as a new attending gets you just as well from point A to point B as the latest $50,000 BMW.

Always Pay Cash

I like to drive nice cars as much as the next guy. Every time I get another one it is nicer than the last. But I always pay cash for it. Not only do you save on interest, but you usually save on the price of the car. Plus, you get to feel like a crack dealer when you walk in with $6000 in 20s that you pulled out of the ATM that morning. (Word to the wise – you'll need to call your bank before trying to withdraw $6000 using your ATM card.)

Buy it Used

Don't buy a depreciating asset on credit. If you can't afford to pay cash for a new car, you can't afford a new car. Buy a nice used one. Don't have the cash for a nice used one? Buy a beater. Can't save up $1500? Start pedaling. And if you're going to own a second car before you're an attending, there had best be a second job to go with it.

I am convinced that a large percentage of Americans spend their retirement funds on driving nice cars prior to retirement. Consider Mike, who buys a new car for $30,000 every three years. He can probably sell it for $15,000. He will likely spend more maintaining, repairing, and insuring the car than his friend Joe who drives the beater down the street. Joe bought his car for $3000 and will drive it into the ground over the course of six years. Mike’s annual cost of car ownership is about $5000 a year. Joe’s is about $500 a year. Over 40 years, $4500 invested at 5% real (after-inflation) is equal to about $544,000. Considering the average person 55+ has less than $100,000 saved for retirement, $544,000 would go a long way.

The money you save driving beaters isn’t limited to the purchase price either. They’re usually economy cars, so you save on gas. You save on insurance because you only need liability coverage. You save on licensing fees and believe it or not, you save on repairs. Not only are parts cheaper on inexpensive sedans, but you also save by avoiding repairs in the first place. When you have a new car you feel like you need to get every dent and ding and broken electric mirror fixed. But no one fixes a dent on a $1000 car. Plus, if you get hit due to the fault of someone else, you make a profit. It doesn’t take much to total a beater. A fender-bender will usually do it. And insurance companies will usually pay you more for the car than you can sell it for. I had one car I bought at auction for $8500 and drove for 4 years before it was totaled. I think the insurance company paid us $8000 for it. Cost of ownership? $125 a year. Not too bad. I might have been able to sell it for $5-6000 if I was lucky.

If you're currently making car payments like most "normal Americans", I suggest one of two options. First, sell the car and buy a beater. Then save up for the car you want. Second, pay off the car. When it is paid off, continue making the same car payment into a bank account set aside as your "car fund." When it comes time to buy your next one, you'll have the cash to do so.

#4 Investment (Margin) Loans

Don't buy securities on margin. Trust me on this. Eventually, the value of the stock or fund WILL drop precipitously. It isn't a matter of if, it is a matter of when. And when it does, you'll get a margin call. If you don't have the cash to cover it, your security will be sold and you will just have bought high and sold low, even if you didn't want to. If you do have the cash to cover it, why did you borrow the money in the first place? If you want to read a horrifying story of a margin investor during the market crash of 2008, check out this thread from Bogleheads.org.

#5 Convenience Card Debt

Did you notice that title didn't say Credit Card Debt. Credit cards aren't for credit. They are for convenience. You know, booking flights, buying stuff online, avoiding trips to the bank or ATM etc.

Studies show you'll spend more when you use something different than cash. As I recall, the order was something like this: Gift Cards > Credit Cards > Debit Cards > Check > Cash. So aside from the costs of borrowing, you'll simply buy more when you use a convenience card. If that doesn't bother you, and you're saving an adequate percentage of your income, go ahead and use a rewards card of some type.

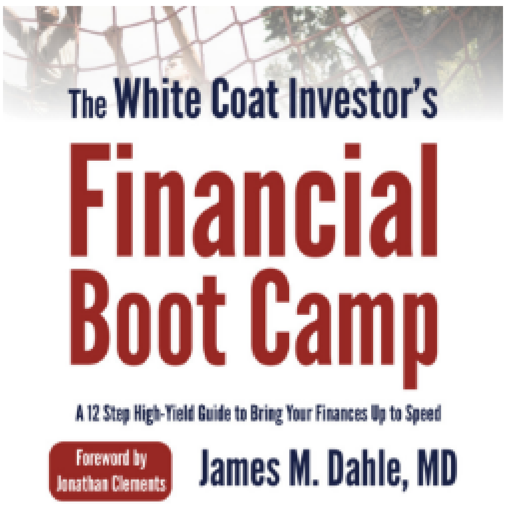
But many of us probably shouldn't use a card at all, and it's easy to tell which camp you're in: Have you carried a balance on your credit card in the last two years? If the answer is yes, you shouldn't buy anything on a credit card. One other question to ask yourself: Do you currently have a revolving credit card balance? If so, you shouldn't be on this site, you should be on this one. Paying off your credit card debt is probably the best investment available to you. You might make as much as 29% guaranteed.

#6 Medical Debt

Get health insurance. Never go without it. I don't know how closely you are associated with your billing department, but you don't want YOUR wallet on the receiving end of the bills I see come out of mine. Not only do cash payers get screwed over by having to pay the whole bill on their own, but without an insurance company to negotiate with hospitals, pharmacies, and all those "filthy-rich" doctors, the whole bill turns out to be much higher. I don't know about you, but our negotiated rates are 30-90% of what our self-pay folks are billed. It turns out that more bankruptcies are caused by medical debt than by buying too many espressos on the credit card.

#7 Other Consumer Debt

Needless to say, if I don't think you should buy a car on credit, I certainly am not going to advocate getting a boat, plane, second house, time-share, ATV, furniture, vacations, TV etc on credit. I don't care if they're offering a 0% interest rate. Get into the habit of saving for what you want. Not only will you save more money in the long run but you'll quickly learn that having more stuff doesn't make you any happier. Or at least that's what I say to my wife when she asks when we're going to finally get around to putting some furniture in our dining room.



In summary, avoid debt as much as possible. Pay off debt, particularly high-interest, non-tax-advantaged debt, as soon as possible. Realize that in a low-interest rate environment that paying off debt may be the best investment available to you, especially since the return is guaranteed. Remember that everything you own owns a piece of you. It is far better for your stuff to own a piece of your past than a piece of your future.

What do you think? Why is it so hard for people to buy stuff for cash? Is there good debt? Why or why not? Comment below!