

## Lesson 15

### Turn On The High Beams

I have shared several counseling experiences with you so far in this study. If there is one common thread in all of the situations; if there is one underlying issue that results in people having less in savings, more in debt and making poorer spending decisions it is this: Most consumers are very near-sighted. They are thinking about today and not next month, and certainly not next year or the year after.



As I alluded to earlier this week, the marketplace encourages our near-sightedness. The sales force wants you to focus on the monthly payment - on the short term. Have you ever driven by a car dealership where the huge billboard out front stated “Only \$39,945!!”? Of course not, it’s always “Only 0.5% interest!” or “Only \$199 down!” It is just another aspect of the American way - part of the instant gratification society that has matured over the last several decades. Young couples think nothing about “buying” a house the size and cost of the one their parents and grandparents worked an entire career to afford. And of course, they are not actually buying the house. They are taking out a huge mortgage that allows them to occupy the house until they move to the next house. I don’t want to beat this horse to death, but out of the hundreds of people I have spoken with, **I cannot think of a single counseling situation (excluding medical emergencies) that was not adversely influenced by this very near-sighted, short term view of things.**

**Remember Proverbs 21:5 - The plans of the diligent lead surely to advantage, but everyone who is hasty comes surely to poverty.**

Over the next few lessons, we’ll look at different commodities and situations where if we would turn on our high beams in order to see much farther down the road, we would experience much “advantage”. **Our near sightedness, our instant gratification, and our very short term focus can all help put us on that road to “poverty”.** Let’s look at ways to avoid that.

The largest and most expensive purchase most of us will ever make will be a house. In an earlier lesson we dealt with the cost of credit and in the previous lesson we saw how long it takes to



pay off a mortgage. Most people would agree they want to borrow the least amount possible, but most don’t fully understand why. By taking a quick look at an amortization schedule, it becomes obvious why we want to borrow the least and pay off the loan as soon as possible.

Amortization is a big and intimidating word, but it is a rather simple concept once we understand it. Let's say we purchase a \$250,000 house by making a down payment of \$50,000 (20%), and taking out a 30-year \$200,000 mortgage at a 5% interest rate. As I write this, interest rates are at historical lows, but you can rest assured they will be increasing. We'll ignore taxes and fees to keep the math simple. The mortgage company will provide lots of paperwork in the process and one document is an amortization schedule – if it is not provided in print, it will be available electronically. An amortization schedule breaks your monthly payment down into two components: the portion you pay the mortgage company (interest) and the portion you pay yourself (increase in principal or decrease in the loan balance). The entire amortization schedule begins with your first month's payment and continues with a monthly entry for a total of 360 months (30 years). **Figure 1** displays the first five payments of the 1st year of the schedule (payments 1 through 5); **Figure 2** displays the first five payments of the 30th (last) year of the schedule (payments 349 through 353).

Notice that the payment of \$1,074 is constant throughout the entire loan because it is a fixed-rate mortgage. During the first year only a little over \$240 of the total payment is going to reduce the loan balance. A much larger portion of the payment (over \$830) is interest on the debt. You can see at the bottom of the First Year chart that you would have paid almost \$10,000 in interest, while reducing the loan balance by only \$2,951. Now look at the same chart for the 30th year of the mortgage (**Figure 2**). The payment is the same, but almost all of the payment is being applied to principal and reducing the mortgage balance and only a very small portion is for interest. At the end of the 30th year you've paid off the mortgage by paying \$12,541 on the principal and only paying \$342 of interest. Why is that? The answer is a key point that you would do well to remember anytime you are considering buying anything using credit.

**Figure 1**

<b>\$200,000 at 5% Amortization Schedule (First Year)</b>				
Payment Number	Payment Amount	Principal	Interest	Loan Balance
<b>1</b>	\$ 1,074	\$ 240	\$ 834	\$ 199,760
<b>2</b>	\$ 1,074	\$ 241	\$ 833	\$ 199,519
<b>3</b>	\$ 1,074	\$ 242	\$ 832	\$ 199,277
<b>4</b>	\$ 1,074	\$ 243	\$ 831	\$ 199,034
<b>5</b>	\$ 1,074	\$ 244	\$ 830	\$ 198,790
<b>End of Year Totals and Balance</b>		\$ 2,951	\$ 9,937	\$ 197,049

**Figure 2**

<b>\$200,000 at 5% Amortization Schedule (30th Year)</b>				
Payment Number	Payment Amount	Principal	Interest	Loan Balance
<b>349</b>	\$ 1,074	\$ 1,021	\$ 52	\$ 11,520
<b>350</b>	\$ 1,074	\$ 1,026	\$ 48	\$ 10,494
<b>351</b>	\$ 1,074	\$ 1,030	\$ 44	\$ 9,464
<b>352</b>	\$ 1,074	\$ 1,034	\$ 39	\$ 8,430
<b>353</b>	\$ 1,074	\$ 1,039	\$ 35	\$ 7,391
<b>End of Year Totals and Balance</b>		\$ 12,541	\$ 342	\$ -



**Key Point: The monthly amount of interest you pay is computed on the remaining balance.**

The sooner the balance decreases the sooner a larger portion of your payment goes to you (principal) and a smaller amount of the payment goes to the bank (interest). **This is the fact that should motivate everyone to borrow the absolute minimum needed and to pay off the debt as fast as possible.** This is true for home loans, car loans, credit cards, revolving charge accounts, etc.

Look at the first year's schedule again. Let's say, for example, when you received your amortization schedule, you noticed the amount of your payment that was being applied to principal the second month of the first year (\$241). If you had an extra \$241 and included it with your first monthly payment instructing the bank to apply the extra to principal, your loan balance would be reduced to the amount listed on the second month of the schedule (\$199,519). What if you included the extra again the next month? If you did, your loan balance would reduce at a much greater rate. This is called pre-paying your mortgage and is an extremely powerful tool to pay off your mortgage much faster, saving thousands of dollars in interest. You saw in the last lesson how the mortgage can be included in the accelerated payoff plan. This is a very similar principle. As a matter of fact, if you included an extra \$241 with each monthly payment, the 30-year mortgage would become a 20-year mortgage and you would save \$69,000 in interest! What if you could only find an extra \$100 to send? That results in a 25 year payoff and saves \$39,000 in interest. How about only an extra \$25? **You would pay your mortgage off over a year and a half early and save over \$11,000! Instead of going to a movie each month and dropping well over \$25, you could turn that amount into \$11,000.** That's a pretty good return on a \$25 per month investment. If you're following the path we've outlined in this study, three things happen when you pay off the mortgage: First, you will reach Milestone 9; Second, you will receive a deed to the property that includes only your name on it (no mortgage company); and, third and most importantly you will be in sync with scripture and you will have only one Master. **The spiritual lightening of the load is inexpressible.** It just requires turning on the high beams and looking beyond next month.

**Another aspect of housing that can benefit from being far-sighted is maintenance.** I taught first-time home buying classes for a few years. Counseling young couples on acquiring sufficient funds for both the mortgage payment and home maintenance issues was always a challenge. I remember one such couple who were dead set on buying. I helped them put their budget together, and it appeared they had enough money to barely make the mortgage payment for the loan they were to sign in a matter of days. The house was an older one which would probably soon need maintenance. I wasn't at all confident that they had enough margin in their budget to deal with the inevitable major maintenance issues. Each time we would look at the numbers, the husband restated that he





was confident he could make the house payment. After an hour of explaining the potential for large expenditures for air conditioning systems, plumbing, electrical, roofing, etc. the wife became very uncomfortable about living “on the edge” with practically no financial safety net. Finally, through tears, she convinced her husband that they needed to delay the house purchase until they had money in an emergency fund that would surely be needed. I remember receiving a phone call from the selling real estate agent chastising me for “interfering with his sale”, but I slept well that night knowing I had been instrumental in saving the couple from a potential foreclosure.

**Consequently, the housing portion of our budget must have enough money allocated to not only make the mortgage payment, insurance premium and taxes, but also enough to handle major house system expenses.** Obviously, potential

maintenance should be a factor in the home buying process. Always have a home inspection conducted by a reliable company. Negotiate with the seller on major maintenance issues. Minimizing the potential for major maintenance expenses when buying a home can be catastrophic on your budget. The information in **Figure 3** will help us visualize the potential future issues by listing the life expectancy of various home systems. The point of this discussion should be obvious. These home systems are all big ticket items.

Life expectancy and costs vary depending on the part of the country in which you live. I recommend you estimate the cost of each of these for your particular situation. For example, let’s say you have a conventional shingled roof. Your house is five years old. You should expect major roof issues within 10 years. If the cost to replace your roof will be \$10,000, then in ten



years, you need to have that amount set aside. \$10,000 needed in ten years means you need to save \$1,000 per year or \$84 per month for the roof. If you allow 10 years to pass and don’t have sufficient funds for the roof, the equity lines or credit cards or other forms of credit raise their ugly heads, and we’ve already seen what that will do. If the roof lasts five years beyond its life expectancy, so much the better. Your emergency fund will be just that much larger when you need it.

You should conclude, as I have, that when we add all of the potential system repairs together, the amount of savings needed is substantial. **Not having enough savings for home maintenance issues creates more problems for home owners than anything else.** This issue is the reason we should arrive at Milestones 6 and 7 before purchasing a home – we are more likely to have sufficient reserve for emergencies. If you have already purchased a home without adequate savings, use the techniques we’ve already discussed to build your savings as rapidly as possible. At the risk of repeating what I have already stated more than once, we need to be looking farther down the road than we do.

**Figure 3**

System	Life Expectancy
Roof	15 years
HVAC	10-12 years
Appliances	10 years
Carpeting	12-15 years
Exterior Paint	7 years





**REFLECTION:** How near-sighted are you? Have you thought about how much more efficient you could be by having sufficient savings? Consider the previous lessons this week on the cost of credit and the accelerated payoff plan. How do those issues combined with the lesson today complete the picture on why we want to have savings to draw on rather than depending on credit to meet emergency needs? If you are purchasing or own a home, what system need are you likely to experience next? Identify and prepare to discuss with your group the statement or concept that was most meaningful to you in this lesson. **Record your thoughts:**

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**ACTION STEP:** If you are beyond Milestone 6 and are purchasing a home, identify an amount per month that can be dedicated to prepaying your mortgage. Using the accelerated payoff calculator link on page A-6, compute how much time would be shaved off your mortgage and how much interest you will save. Estimate the cost to you of the house systems listed in the life expectancy chart, and include that amount in both your short and long term saving goals. Continue tracking your daily expenses using the spending areas listed on page A-4.

