

# Chapter

# 11

## The Major Expenses

At some time in life, many people will face four major expenditures:

- financing education (or training)
- buying or leasing a car
- accommodation
- raising a child

### FINANCING EDUCATION OR TRAINING



#### An Education Financial Strategy/Plan

Try to complete the following activity in less than two minutes. For those of you who are planning to go on to further study, this activity is designed to enable you to make a plan for your further education. Make an estimate of what your personal costs and income might be per year. The sample worksheet on the next page may be helpful.

For our purposes here, we will assume that you are considering additional education that will require funding. The same basic factors would hold if, alternatively, you are planning to pay for training.

A good education can be a very significant investment that will affect your ability to obtain financial resources throughout the rest of your life. You may believe that you have good reasons for not pursuing your education further, but make sure that they *are* good ones because there are many advantages to carrying educational credentials with you. If expense is one of the factors that is preventing further education, that is all the more reason to begin financial planning today so that you can come back to your education in the future.

## SAMPLE WORKSHEET

### COSTS

#### **Basic Living Costs per Month**

Accommodation (utilities included) \_\_\_\_\_

Food \_\_\_\_\_

Local public transportation \_\_\_\_\_

Miscellaneous: telephone,  
personal and health care, etc. \_\_\_\_\_

**Total basic living costs per month** \_\_\_\_\_  
(not including clothes and entertainment)

**Total basic living costs for the school year = 8 months** \_\_\_\_\_

#### **School Costs per School Year**

Tuition fees \_\_\_\_\_

Books and supplies \_\_\_\_\_

Moving furniture to school, etc. \_\_\_\_\_

Transportation to get home for  
vacations and the summer \_\_\_\_\_

**Total school costs for the school year = 8 months** \_\_\_\_\_

**Total Overall Costs per School Year** \_\_\_\_\_

### SOURCES OF FUNDS

**Expected Parental Contribution per School Year** \_\_\_\_\_

#### **Your Contribution per Year**

Summer's income after taxes and  
living costs \_\_\_\_\_

Scholarships/awards \_\_\_\_\_

Savings/investments \_\_\_\_\_

**Your total contribution per school year** \_\_\_\_\_

**Total Funds per School Year** \_\_\_\_\_

If the total anticipated costs exceed the anticipated funds, you may have to consider applying for loan assistance. But remember that a loan is a debt you will have to repay at some point in the future.

Taking on debt to help pay for education is quite common today and may become more so in the future as costs related to education rise. This can be a wise investment, provided the education you receive helps prepare you to earn an income that can be used to repay the loan. The goal should be for the loan to help finance education that will prepare and enable the borrower to earn more lifetime income than would have been possible without the loan. That would make it a good investment.

Problems arise, however, when loans are taken to help pay for an education that, when completed, has not helped prepare the borrower to generate an income — or an income better than what would have been possible without the education. It is not uncommon for students to leave college or university with debts of \$15,000 to \$25,000. That is a significant burden with which to begin one's working life. You should also keep in mind that years of college or university have an "opportunity cost," that is, the loss of income that otherwise could have been earned from working.

That is why it is important to make the most effective education choices and decisions you can. Borrowing for an education can be a very good investment decision. But, like any investment, it will be judged by the returns and benefits it generates.

## TIPS ON BUYING A CAR

For many Canadians, one of the first major purchases they will make is a car. The following are some general tips to help insure that you make a good decision with respect to the car that you buy.

- Explore various possible sources for a car.
  - dealers
  - private sale
  - cars that were repossessed and are being sold off
  - car rental companies
  - taxis and police vehicles (be aware, though, that used cars that served as taxis or police vehicles, for example, may have received pretty hard use)

Do your homework. Look around. Read up. There are laws to protect you. Get to know them. Check prices on the lots and in the papers. Know what type of car you want before you go out to buy it. Know what its approximate value should be.

- Never buy a used car without having it inspected by a mechanic.
- If you buy a used car, check:
  - for rust on the surface and under the car
  - the compression in the engine — a mechanic will do this for you and tell you how good the engine is
  - whether the car has been painted
  - whether it has been in an accident

- if there is much movement from side to side in the front wheels indicating problems with the front end of the car
  - if the tires are worn unevenly indicating a problem with the alignment
  - if the car continues to bounce for a while when you push down on it indicating there is a problem with the shocks/springs
  - whether there is much play in the steering wheel
  - how good the brakes are during a test drive
  - the smoke from the exhaust — is it white, which is normal, or is it black or blue indicating problems
  - if there are any leaks under the car; let it sit in one spot for a while, then move it and check
  - the acceleration of the car and the shifting of gears
  - how the car corners during a test drive
  - the condition of the exhaust system — rust etc.
  - wear in the interior
- Set a limit on the amount that you are going to spend for a car and stick to it.
  - If you buy a used car, make sure that there are no liens against it, that is, someone might have taken out a loan and used the car as collateral. If they did, and the lien still exists, then the car can be taken from you and sold to pay off the debt.
  - Check the history of a used car. Contact past owners if you can by tracing the history of the car through provincial records.
  - Bargain. Negotiate. Do this even if you are buying a new car — dealers will bargain.
  - Buy in the winter, if you can, when fewer cars are purchased. Demand is lower and you may be able to strike a better deal.
  - Keep up regular maintenance on a car — it more than pays for itself in the long run by helping to avoid major repairs.
  - Beware of out-of-province cars, which may have been brought in from areas where inspection regulations are less strict.
  - Read all contracts carefully.
  - Never sign an offer for a car until you are absolutely sure that you want to buy it.



- Don't be pressured into a sale. If you feel you are being pressured, back away and think about it. People are especially likely to be influenced by a friendly or aggressive salesperson.
- Check any warranties that are offered to see who backs them — the manufacturer? the dealer? an insurance company?
- Check the reputation of any rust-proofing company.
- Don't buy a used car without seeing proof of ownership of the vehicle.
- Check the consumer reports publications and other books to research the record and reputation of the car you are considering.
- Be aware of the operating costs of a car, which include:
  - fuel
  - oil
  - tires
  - repairs
  - licences
  - registration fees
  - insurance
- Make sure that any car that you test drive is insured (and that you are, too).
- Listen to the engine, not the radio — you can do that later.
- Get a receipt for any sale, and make sure that it states any equipment on the car that is to be included that might be removed by the current owner.
- Should you get a new or used car? Do you have a choice?
  - used cars are cheaper
  - used cars depreciate (that is, lose their value) less quickly than new ones
  - used cars usually cost less to insure
  - new cars usually need fewer repairs, and they are often covered by warranties
  - used cars often aren't backed up by a dealer who you can go back to if you have a problem
  - used cars usually cost more to operate
  - you don't know how a used car has been handled or driven by previous owners
- Make sure that you really need a car. What are the options (bicycle, public transportation, etc.)? Is it worth the expense?
- Enjoy your car if you get one, and drive safely!



## ACCOMMODATION

### MOVING OUT

Moving out on your own away from family can be a difficult adjustment. In addition to the financial obligations you take on, there are often many emotional aspects associated with it. Here, we will just give our attention to some of the considerations both financial and otherwise that you should keep in mind.

Will you move out on your own or with one or more roommates? If you move in with a roommate or two, who will they be? Living with friends, as you've probably heard, is not as easy as one might think. It is a lot different living with someone than going to a show or out to dinner with him/her. It is usually a good idea to establish the house rules and guidelines at the outset.

Consider the following possible conflicts:

- differences in work/study habits
- differences in neatness/cleanliness
- differences in terms of organization
- differences in eating habits
- differences in tastes/entertainment /TV/music
- problems with use of the phone
- differences in friends
- competition for the bathroom

The following are some other things to consider.

- Decide whether you will seek furnished or unfurnished accommodation. Which would be cheaper for you? Do you have any of your own furniture?
- Are utilities (oil/gas/electricity/water/cable) included in the rent, or do you have to pay for any of them?
- How close will you be to school or work? Does the location add to, or save on, transportation costs?
- If you are moving out to go to school, do you want to live on campus or off? If on, can you get into residence? If off, can you afford it? Does it cost more or less?
- What services are provided by the landlord? What are your responsibilities?
- Check, where possible, your provincial landlord/tenant agreements so that you are familiar with all conditions and your rights.

- If you have a car, is parking available? If not, is parking available nearby? If so, do you have to pay extra for it?
- What is the neighbourhood like? Safe? Attractive?
- What are the neighbours like? Quiet? Noisy? Friendly?
- Check things such as the plumbing, wiring, and appliances. They can become very important to you once you move in. Besides, you also want to ensure that they are safe.
- Is there any storage space available if you need it? Does it cost?
- Check your provincial rent control policy, if any, to see if it affects your situation and the rent that you pay.
- Do not rent a place sight unseen. This may sound like a crazy notion, but there are actually situations in which the demand for rental property is so high, and relative supply so low, that people will rent a place over the phone without looking at it.
- Check to see what access your landlord has to your place. Usually a landlord can only enter for an emergency or after giving you prior notice of 24 hours or so.
- Check the security of the property.
- How much notice do you have to give before leaving?
- Be aware that you may incur moving costs — unless you are lucky enough to have friends with a truck or a trailer as well as strong backs.
- Be prepared to pay the first and last month's rent. This is a common practice. The landlord holds the last month's rent as protection. However, you should be paid interest on that money.
- Make a list of the utensils, dinnerware, small appliances that you will have to obtain. These costs can add up.

These are just some of the things to keep in mind when you decide to move out. Although not as costly as the purchase of a home, that first move out can bring many pressures, stresses, challenges, problems, and expenses. Plan it well. Speaking of purchasing a home, let's take a look at that big step.

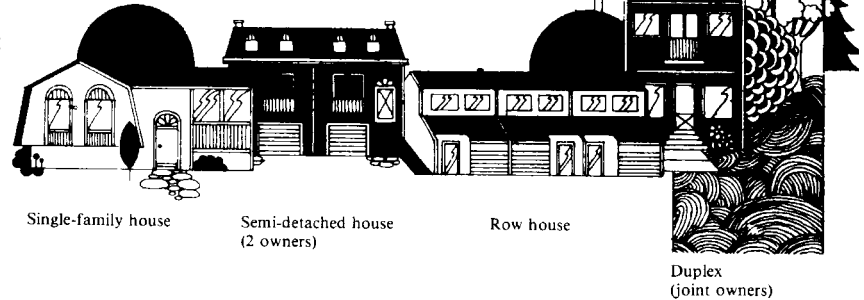
## **PURCHASING A HOME**

As was mentioned earlier, this is a step that many Canadians never take. But for those who do or will, and this may include you, here are some of the important things to note.

## TYPES OF HOMES

One of the major decisions you will have to make concerns the type of home to buy. The following are possibilities:

- **Detached house:** a house that stands on its own unattached to any other building
- **Semi-Detached:** a house that is attached on one side to another house
- **Townhouse (Row House):** a house that is attached to another house on both sides



Source: *Protect Yourself*, vol. 8, no. 1, December–January 1980.

- **Duplex:** a house in which there are two separate living areas, for example, one upstairs and another downstairs (triplexes have three living areas, fourplexes have four) — may be detached, semi-detached, or attached on both sides
- **Condominium:** an apartment that you buy rather than rent
- **Mobile home:** many areas in Canada have mobile home parks where people live in mobile homes
- **Co-op:** situation in which you purchase a property in conjunction with others; for example, you may own an apartment that is part of a co-op where the members of the co-op own and manage the building

You will have to decide what type of housing you prefer and what type you can afford. Unfortunately, the two don't always go together. Generally, detached houses cost more than semi-detached. But there is another factor that affects price that is as important as (perhaps more important than) the type of house, and that is location.

House prices will vary dramatically according to the location of the properties. If the property is in a highly desirable, high-demand area, the price will generally be bid up quite high. When you begin your search for a house, the hot areas will soon become apparent.

Let's look a little more closely at the financial aspects of buying a home.

## MORTGAGES

You've probably heard this awesome word — probably followed by sounds of moans and groans. A great many homeowners have a mortgage. A mortgage is simply a loan that you take out to use toward buying a home. It is a debt that

you have to pay back. And for many Canadians it is quite a high debt, hence the moans and groans.

Consider as an example a house that costs \$240,000. If you are like most Canadians, you wouldn't have \$240,000 that you could use to pay cash for your home. You would have to borrow money to pay for it. That is, you would have to take out a mortgage.

Let's start with a couple of points at the outset. It is not as difficult to borrow large sums of money toward a mortgage as you might think. The main reason is that the creditor, the financial institution that can loan you the funds, is pretty assured of getting the funds back. Why? Because the funds are invested in an asset — the house. If you don't keep up the payments on the house, the house could be sold to get the funds to pay back the mortgage.

That is why financial institutions will want to send an "appraiser" out to check the property you are planning to buy prior to giving you the loan. They want to make sure that you are not paying more for the house than it is worth — and to ensure that there would be at least enough value in the property for them to be able to get their funds back.

There may be a limit to the amount that financial institutions will provide for a basic mortgage, for example, 75% of the purchase price. In our example, a mortgage could be provided for \$180,000 (75% of \$240,000). However, it is often possible these days to obtain a larger mortgage (above 75% of the value). Investigate this possibility whenever you consider taking out a mortgage for more than 75% of the purchase price of a property.

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#### **What's the Maximum I Can Borrow?\***

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<i>When Mortgage Rates are:</i>	<i>Multiply Your Pre Tax Annual Income by this Figure to Determine the Maximum You May be Able to Borrow</i>
4%	4.6
5%	4.2
6%	3.8
7%	3.5
8%	3.2
9%	2.9
10%	2.7
11%	2.5

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Let's assume that in our example the purchaser has managed, through effective planning, to accumulate \$40,000 and has taken out a \$200,000 mortgage to buy the \$240,000 home. Paying off a \$200,000 debt is a lot harder than paying

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off a \$3,000 debt. It also usually takes a lot more time. By making reasonable payments, you should be able to pay off a \$3,000 debt over a few years or less. But what about \$200,000? People can take a mortgage out for a 25-year period. That is, they will make payments over a 25-year period. (You can understand why people celebrate when they have finally paid off their mortgage.)

You can now appreciate that taking so long to pay back a debt means that the amount of interest that is paid is considerable. Therefore, when, or if, it comes time for you to take out a mortgage, if you can pay it off over a shorter period, do so. It will save you a great deal of money.

If you take a mortgage out for a 25-year period, the 25 years is referred to as the amortization period. And, since a mortgage is a loan, you have to pay interest. Probably you are also aware that interest rates change quite frequently. So even though you are going to pay the loan back over 25 years, creditors will be unlikely to guarantee that you will always pay the same rate of interest over the 25 years. They will want to negotiate your mortgage interest rate over a particular “term” — a six-month term, a one-year term, two years, three years, four years, and so on.

It's not very common these days for an institution to provide a loan for more than five to seven years. After the term has ended, you renegotiate the interest on the mortgage for another term. This continues until the mortgage is paid off.

So when you take out a mortgage, you need to make a number of decisions.

- How large a mortgage do you need? (The actual amount you borrow, as with any loan, is called the principal.)
- From whom will you borrow? (Again, as with any loan, shop around. Institutions will compete for mortgage business.)
- Over what period will you amortize the loan (that is, how long will it take to pay off the loan)?
- What interest rate will you pay? This will vary according to the term of the mortgage that you choose. Usually the longer the term, the higher the interest rate. In general, if you think interest rates are likely to decline, you may want to go for a short term (for example, six months). This will let you renegotiate when you want to take advantage of the anticipated lower rates. Remember, though, that interest rates might go up instead. If you think rates will rise, you might want to lock in for a few years at the current rate (for example, take a five-year term).
- How frequently will you make payments? You may pay monthly, bi-weekly, bi-monthly, or weekly. Pay as frequently as you can. You can save a great deal of money by paying on a weekly or bi-weekly basis.
- Will you take out an “open” or “closed” mortgage? An open mortgage allows you to pay off your mortgage at any time. A closed mortgage means you



**MORTGAGE  
CHOICES**

can't get out of the mortgage until the term is up unless the lender agrees (and the lender will usually charge you a significant penalty). You should be sure to ask about prepayment privileges. Most institutions let you pay off a certain percentage of your mortgage (for example, 10%) each year.

There are a few other things you need to know about buying a home. The degree to which you own your home (versus how much of it the mortgagee holds) is referred to as your "equity." If you pay \$40,000 toward an \$140,000 home, then you have \$40,000 worth of equity. If the value of that home should rise, to say \$160,000, then your equity increases. You still owe the balance of the mortgage, but your equity has increased by \$20,000. The more quickly you pay off your mortgage, the more equity you have in your home.

It is in this way that some people use housing as an investment. You have probably seen examples. Someone will buy a relatively run-down house for a modest or low price. They then fix it up and sell it for a higher market price and keep the gain. Others will buy a first home in an area where they think housing prices will rise in the future. They will stay in the house until prices rise, sell it, take the gain, and move to a new house. (But surprises occur when prices fall. It's by no means a sure thing.)

If you buy a home, live in it as your principal residence, and sell it later at a higher price, you do not pay tax on the money you make. However, if you buy a house, rent it to someone, and sell it later for a higher price, the increased value is considered capital gain, which is taxable income.

Finally, be aware that there are a lot more costs to running a house than just the mortgage, for example, taxes, utilities such as water and hydro, repairs, heating, home insurance, and general upkeep.

This may go a long way toward explaining why you didn't get that pony you asked for when you were growing up, or that new bike, or maybe why you can't have a computer today. The financial burden of paying for a house is a heavy one. It also involves a lot of trade-offs. As we said, a house is the largest investment that many Canadians make in their entire lives. If one day you decide to purchase a house, do all you can to make sure that you make a good buy.

Spending is only one thing we do with our money, though. You will also hope to be able to save some money. If you do, what you do with your savings becomes important. If you just put them under a mattress, inflation may reduce the purchasing power of your money over time. There are many options for what people can do with their savings. One common use is to "invest" to try to earn a return, increase the level of savings, and increase the purchasing power of the funds saved. Let's turn our attention now to the topic of investment.