EPISODE 1494

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FT: So Money episode 1494, Ask Farnoosh, affording life's biggest purchases.

[INTRO]

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FT: Welcome to So Money, everybody. I'm Farnoosh Torabi. You're listening to our Friday episode of Ask Farnoosh where soon we will be joined by our special guest today. Thanks to our sponsor, Prudential, we have certified financial planner Mary O'Malley from Prudential here to help us navigate your money questions, all under this theme of affording life's big expenses, purchases. I know a lot of us are out there hunting for a home. You might be looking for a new car. You want to start a business, start a family. How to make it all happen.

Ahead of that, let's talk about what you may have missed this week on So Money. On Monday, I chatted with Amy Porterfield, who is the New York Times best-selling author of *Two Weeks Notice.* We talked about how to quit, how to quit with financial runway, how to not burn bridges, and how to test your entrepreneurial idea to know that it has legs. Amy herself gave *Two Weeks Notice* years ago to none other than Tony Robbins. She was working for him. It wasn't a straight path, but she's very open about her experience and talked about the dos and don'ts of giving your two weeks' notice.

Then on Wednesday, we chatted with Allison Baggerly who's the creator of Inspired Budget, a massive community that educates around budgeting, spending wisely. Allison has a new book out called *Money Made Easy,* and she shared some insights on how to spend. We often forget how to spend money, which is kind of what we're talking about today. We often talk about getting out of debt, investing, all important. But let's remember that spending is also a critical way to use your money. I really appreciated that conversation. Tune in if you haven't already.

This is another big thing. For those of you who want to join me for a live call on how to leverage fear to manage your money, you want to preorder *A Healthy State of Panic* by today. Today is the deadline for the earliest birds to preorder the book and then be invited to this free one-hour live call where I'll be going through my steps for how I've leveraged fear to create wealth in my life. Also, there will be other giveaways, including one-on-one money sessions, books. You don't want to miss this. All it takes is preordering the book. Go to ahealthystateofpanic.com to learn all about this and get on our invite list for this call, which is happening in just a few short weeks.

All right, next. Let's go to our Apple Podcast review section and pick our reviewer of the week. This person will get a free 15-minute money session. Okay. This week, we're going to say thank you to Sarah. Sarah Mayer who wrote, “I need So Money in the morning like I need my coffee.” Sarah is a 41-year-old mom and teacher from the Detroit area. She says, “I've listened to your podcast for about a year, and I want to sincerely extend my gratitude to you for being such an integral force in my financial education. I was always the person who skipped checking my student loan balance out of fear, believed money doesn't buy happiness, and ignored my own money story. But your podcast has been a salve in my life, which has helped me slowly change those behaviors.”

Sarah, let's talk about your money fears. It looks like you figured it out. But this is my jam. I would love to help you even more. Email me, farnoosh@somoneypodcast.com. Let me know you left this kind, kind review, and I will reply with a link where you can pick a time for us to connect. All right, let's head to the mailbag and bring on our special co-host this Friday. Prudential Certified Financial Planner, Mary O'Malley. Mary, welcome to So Money.

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MO: Hi, Farnoosh. Thank you for having me.

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FT: Yes. Before we get to the mailbag, I love your personal career journey. I don't know if you knew I was going to ask you this. Not to put you on the spot but I had to talk about your transition to financial planning. You began as a special ed teacher. I thought that was really fascinating, and I wanted to know what drew you to helping people with their money.

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MO: Yes. Thank you. That's a great question because it is a bit of a different career path than I had gone to school for. Much of this journey was really born out of my own personal failures managing money. Shortly after I finished my master's degree, I was just really stressed out financially. I was single, making decent money, but living paycheck-to-paycheck, and just didn't feel that I had a good handle on my own personal finance. So it really – this journey started in, I would say, early 2000s. It was just, again, born out of my own inability to manage money.

So that's how I really relate to my clients a lot because there's so much shame in when it comes to debt and just managing money. We all get so overwhelmed because there's just so many options. There's so much to know, and I remember feeling that way. So that's what took me on that path. It was really fun to, one, just overcome my own struggles and then be able to eventually help others. So that's been something that's given me a lot of joy.

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FT: I can imagine. Well, we're grateful to have you on the show to help us navigate these questions from our audience about affording life's big purchases. I love what you said about shame, Mary. I guess we should preface by saying, look, I mean, we're going to talk about these big expenses that often feel like such milestones, like buying a home and starting a family, raising kids. Maybe you want to build a business one day.

It may not all happen exactly how or when you anticipate. But that's not something to feel bad about. I just want to maybe start with that. That you may not even ever buy a home, and that's okay too to not feel as though your financial purchases define your self-worth and how you see yourself as a person leading a meaningful life. Would you say that's fair?

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MO: I would completely agree with that statement. In many of my meetings with new clients, I always like to set the table with that because I always remind clients that I can only help them as much as the information I know, much like a doctor, right? If you don't know everybody's background, then you can't really help them to your best abilities. So there's a lot of shame in debt. But if we don't really address it, acknowledge it, and learn how to wrap our hands around it, and create a plan to get rid of it or pay it off, then we can't do our best work unless we know about it.

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FT: Isn't that the truth? Okay. Well, let's start with what's so popular right now. It's the spring home-buying season. Sadia is this year a first-time homebuyer. She is in the market, and she says, "Interest rates are really high. Should I wait to buy the market is kind of unpredictable?" She's talking about more like the broad market, right? The job market, the stock market, and all of that does inform our decisions when we're trying to think about paying a lot of money for a home. We don't necessarily want to do it if we feel like the economy's not doing so great.

But what's your assessment of things? How do you go about calculating with your clients? How to afford a first-time home and not trying to get too bogged down in the macroeconomics of things?

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MO: Yes. Yes, that's a great question. It's really important to sit down and understand your financial picture. Like you said, you really have to be really down and dirty and honest with yourself about the numbers. So cash flow planning with my clients is really important. We need to know what's coming in, what's going out, what you have saved. You want to look at your credit score too because interest rates are really high. So the better your credit score is, the better interest rate you might get.

One of the benefits we can see, though, in these higher interest rates is that it is starting to help bring down the home prices. I have a lot of friends and clients who were actually looking to purchase a home this spring. Over the last year, it became very discouraging. Many of them had gone to make offers and lost out. People were paying over 20% over ask. It's really hard to be in those bidding wars.

So these higher interest rates are putting a little bit of a crunch on home prices. Maybe bringing them, resetting them a little bit, putting them back to more numbers that are more in line with what the true value of the home is. I always remind clients, you can refinance your mortgage. But once you pay 20 or 30 percent over ask, you've just locked in that price. So maybe getting a higher interest rate, it's not great. But interest rates will eventually go down. You can always refinance. You can't repurchase that home, right? That price is locked in.

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FT: Right. You can't go back into the seller and say, "Can I pay you a little bit less?"

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MO: That's right. I overpaid by 20%.

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FT: I think it should be said because for Sadia and others who are first-time homebuyers, maybe they are not well aware of where interest rates have been in the past. They're looking more to the last five years when they were ultra-low. I remember buying a home in 2004, and the rate was about six percent. So that's around where we are today. To think that this is astronomical and it's not.

This has happened before and not so long ago. But you're absolutely right that you can refinance because that's essentially what I did. I refinanced a couple of years later to more like a four percent rate. So there is always that potential. You talked about cash flow, so important. What's a good benchmark? What's a good threshold to keep your spending at on a first-time home when you're talking about your monthly budget? A lot of times, we hear the rule of thumb of 30%.

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MO: Yes. So there are so many different rules of thumb, and I always remind. I think it does give clients a good benchmark. But everybody's situation is going to be a little different. It's good to hear those, so you can kind of frame your thinking. Sometimes, it's three to five times your income. You really don't want to be paying more than 20% of your gross income on your mortgage payments, so looking – again, so you have to know what your numbers are. What is your income? That would be gross income.

But still, I think a lot of times, people look at more net. So what is my take-home pay? What can I afford on a monthly basis? Because you don't really want to go all – you have to factor in all of the other expenses as well. Being a homeowner does include a lot more expenses. It's great because you build equity, and you've got something to show for it. But you do have to pay attention to the taxes, all of the repairs that can go into owning a home. There's a lot of unforeseen expenses that can arise as a homeowner that you don't necessarily have as a renter. So making yourself aware of that is really important.

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FT: Yes. You brought up the home repairs. Kohli in the audience wants to know, "When is it a smart time to leverage a HELOC, a home equity line of credit, for the purposes of renovating your home?" Again, rates are slightly higher than they were. Well, not slightly. They're double what they were, let's say, two years ago. So is this still like the best way to borrow to build a new kitchen in your home? What are your thoughts on that, Mary?

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MO: Yes. So I think you'd want to do your research. One of the good things, maybe one benefit of these home prices being so high is that you could potentially have a lot of equity in your home that could afford you a good amount to borrow from. So you would want to speak to a lender to find out how much equity you have in your home. Then how is that going – what is that going to cost you to borrow that money? How is it going to be structured? That's important. Making sure you don't have a variable rate. Rates have gone up. They may potentially continue to go up. So you want to be really careful of that.

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FT: Just to add to the whole HELOC conversation, Mary, I actually just took out a HELOC. We bought our home in 2020. It has appreciated since. For me, the HELOC – I don't have a home renovation in mind. I don't have really anything in particular that I want to use this for yet. But I recently had a big tax bill. I paid off some business loan debt. My liquidity and my savings was going down. I thought, well, I know I'll be able to replenish this over the course of several months.

But it would make me feel better sleeping at night, knowing I had access to some low-interest debt, relatively low-interest debt in the event of like something else happening that I can't imagine. I wasn't expecting a high tax bill. I wasn't expecting to pay off my debt so soon this year, but here I am. So also to afford life's what ifs, it can be wise to take out, if you can, this. I don't have to use it until I'm ready. It doesn't start charging me until I use it. So that's good.

But I'm just keeping this in my break-open emergency glass, just in case something else that I wasn't anticipating, a big expense, pops up in my life. I don't want to necessarily take out of my savings because that's really there for cash flow purposes to be able to fund our lives in the event of like a layoff or something like that for us. So I hope you would advise that is okay.

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MO: I would completely agree with that. In fact, we do that. I have several clients that anytime you – especially when you own a home, you want to make sure you have about six months of living expenses. The rule of thumb can vary if there's a dual-income family. It could be as low as three months. I always say at least six months' worth of living expenses liquid for those occasions that you speak of.

But I have some clients that are a little bit more aggressive. They don't want to keep that much in cash, but they'll use their HELOC for that purpose. So they've got access to that money if they need it. Again, they aren't being charged anything. So if they need it, it's there for them. But then, that frees up other cash for other purposes or investments, things like that. But, yes, I think it's a great way to leverage resources for yourself.

It's also a lot less – well, I hate to make generalizations. But typically, it could be a much more inexpensive place to get credit than, let's say, a cash advance on a credit card or something like that.

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FT: It's a relatively safer way to borrow. But I would make sure that it's for a project that's going to have a really good ROI and/or, for me, it's buying peace of mind and preparing myself even more for life's what ifs.

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MO: Agreed. I totally agree with that statement.

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FT: All right. Let's – speaking of what ifs, this is great. You didn't know you were helping me transition so well here, Mary. But we have a question in the audience about another sort of what if, which is medical expenses. A lot of this episode is dedicated to the expenses that we plan for, things like homes and cars and family, raising a family. But some of these big expenses we cannot predict, and that includes an injury, an accident. Of course, we would help everybody has health insurance and maybe even disability insurance.

But as we know, there are significant out-of-pocket costs to deal with in many cases. What are some ways supplemental insurance can help? There's a few categories of this. There's hospital indemnity, accident and critical illness insurance that can help pay for costs that we would, otherwise, pay for through savings or, let's be honest, taking on debt. This would be in addition to any other coverage that you may already have. I just want to get your thoughts on when it may make sense for somebody to invest in this.

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MO: Yes, that's a great question because the foundation of good financial planning is risk management. So you need to be cognizant of all the potential risks that can really devastate your financial well-being. One of those is premature death, disability, chronic illness, anything that's going to disrupt cash flow, right, incoming paychecks.

So one of the ways I always advise my clients too, one, I have to point out their potential risks, right? Or some of their blind spots that maybe they haven't been paying attention to. Because very rarely do I get incoming calls about, “Mary, I need to get more disability insurance, or life insurance, or critical illness insurance.” Unfortunately, we don't get many of those calls. People recognize the risks. They recognize the need to do it.

But they can tend to be very reluctant to go out and seek that. So as an advisor, it's my job to shine a light on that blind spot and that potential risk. So anytime there's risk, we decide. Do we want to transfer that risk, or do we want to assume that risk? I always tell people, usually, especially with disability or premature deaths, that's a risk you really want to transfer to an insurance company.

So some of the best ways to do that is, one, look at what your employer is going to offer. Anytime you can get something on a group plan, it's usually going to be much more cost-effective. Now, there's always going to be stipulations and fine print. So make sure you're aware of that as well. But that's a great place to start. Look at what you can get through a group benefit. Again, it's going to be more cost-effective. Then you can look outside of maybe a group plan. Speak with a local agent that can let you know of all the different ways you can, again, manage and transfer that risk.

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FT: The price is often a barrier to purchase. But it could also be the sort of thing where, to your point, when you do the risk assessment, the price makes a lot of sense.

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MO: Yes. Again, it's about transferring risk, and you want to assume that risk of an accident, a diagnosis, something that can really be very financially devastating to you and your family.

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FT: Okay. Let's move on here to talking about purchasing a car. During the pandemic, it was impossible to locate a car to buy. My audience probably knows this if they've been listening since at least the last couple of years. For our second vehicle in our home, I decided to lease it, despite the traditional financial advice that I always understood, which was like you buy a used car, you pay cash. Like, okay, well, that's in an ideal world.

But I thought that leasing for me at least made most sense for this second vehicle because I wasn't going to drive it as much. So it would be a low-mileage, low-wear-and-tear kind of car. If I'm being completely honest, I kind of wanted a fun car. We have the safe stable car for the family. Then for me, I work hard. I want to enjoy the drives. So I went a little in a different direction with the lease, and I don't regret it.

I know that there are many schools of thought on how to purchase a car. But when it comes to advising clients, Mary, on how much to pay for a car or how to afford it, what's the good balance? You talked about 30% on a home. I've heard like 15% or less on your take-home pay towards car payments if you're taking out a loan. What are some of the things people should know before they purchase a car?

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MO: Yes. Well, there's a couple of things. I think it's really important to know. Most people are trading in a car. So make sure you know the value of your car and what you should be getting for that. Then know your credit score. So if you can't afford to outright buy the car, have a good understanding of probably what you're going to have to pay in interest. Maybe go to a couple of different lenders, outside of just build the car dealer. So you can have a good understanding if you're getting a competitive rate.

But I also just go back to cash flow planning. I talked with my client. Nobody really likes the B word. I have one client who said, “You stop saying that B word.” She was referring to budget. So you don't – budget has such a restrictive tone to it. It's not necessarily about budgeting, but just know what's coming in and know what's going out. So know what your fixed and variable expenses are because you really should know what you can afford.

We do all get tempted. We spend a lot of time in cars. If you've ever noticed, you never see a bad car, a rusty car driving around anymore. So we do tend to spend money on our cars. As long as we can afford to do so, then I say don't deny yourself certain privileges. We all work really hard. As long as you're paying yourself first and it fits in your budget or your numbers, then allow yourself some of those luxuries in life. Because, again, like you said, Farnoosh, you work really hard. If it works in your numbers, make it work. But know what your monthly budget, both on the fixed and variable side, can afford.

Another rule of thumb is try never to have your total debt exceed 40% of your gross income. I always say just try to keep debt at an all-time minimum. Like I said, I got into this career really out of my own personal failures. I had a tremendous amount of consumer debt. I was paying very, very high interest rates, and I had no idea. Through this this process of learning about personal finance, I became very aware of paying attention to interest rates because that can have a really – I always tell people, it's compounding interest but in the wrong direction, right? So you’ve got to pay attention to the interest rate that you're paying. I think it's important.

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FT: Yes. One more thing, if you do choose to lease. I remember when I was running the numbers at the car dealer. The sales manager, he was very frank with me. He said, “How much do you feel comfortable paying every month? We'll make the numbers work.” That may mean getting a different model. Or instead of 36 months, we do 48 months, right? We can stretch out the payments. But I think it's important to be upfront with the car dealership about what your budget is.

I would suggest going with someone. I went with my brother, who is much more experienced in buying cars and communicating around this sort of stuff at the dealership because I didn't want to feel like I didn't know what I didn't know. I wanted to have an advocate with me there. You know what? Thanks to Todd, my brother. He got me some free, what do they call it, winter mats.

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MO: Awesome, Todd.

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FT: Yes, right? I mean, those – He's like, "Farnoosh, those are like $500."

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MO: Right. That's great.

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FT: Yes. Because he was like, "Can you throw in those for us?" I was a little embarrassed, but I got them. I got them.

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MO: Hey, there's no shame in that thing.

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FT: Bring an advocate.

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MO: That's right. I agree. I remember when I purchased my first car after – in the adulting world. My dad went with me. But it was so important to me that I did a lot of that on my own because I wanted to feel like I was doing – that was my first big purchase, and that was fun too. So I just recently read an article, and it was interesting because I too am looking to purchase a car, though, I'm also maybe trying to push it off, hold it off a little bit waiting for interest – or, excuse me, not interest, but maybe inflation to come down a little bit.

But they were talking about the best time to buy a car. Ironically, going to the showroom during the weekdays and towards the end of business, they said, according to their research was the best time to go car shopping.

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FT: That's a great tip. That's a great hack. All right. I hope we helped people there with their car-buying decisions. Let's move on. We have two more themes here. One is affording kids which could be its own episode, and I have done many of them on So Money. So listeners, if you want more after this, just search topic on somoneypodcast.com, and you'll get deeper into a lot of these topics we're covering with Mary.

But we want to talk about affording kids and then also getting ready to start a business. We just had on a guest on So Money, Amy Porterfield, who talked about building financial runway ahead of launching a business. So we can piggyback off that a little bit. But first, Mary, having kids, I have two of them.

The question here from our audience is how can you tell if you're ready to afford a child. I guess they're wondering like should I be making a certain amount of money? Should I've cleared off all of my credit card debt? There's no perfect time, I think, to have a kid. What would you say?

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MO: I would agree with that. So I have **[inaudible 00:25:40]**. My husband and I, we tried to wait for the right time financially. But my mother kept saying, "There's never the right time financially. Just do it. You'll figure it out." Now, as a financial adviser, I probably shouldn't give such lackadaisical advice. But I do. There's a degree of honesty in that. Kids are very, very expensive. I did listen to that episode that you did on So Money, and it's so true. What is it? Like $500,000 to raise one child from 0 to 18.

Now, honest –

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FT: That's not including college, right?

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MO: Right. You're right. That's just to 18. That's just had launched them out of high school. So realistically, nobody's going to be able to save that much up to do that. But, again, I'd go back to cash flow planning. Know your numbers. Try to live as far below your means as possible, especially when planning for expanding your family. If you do have consumer debt, find out what you're paying in interest rates.

One of the things that I did was just going back and forth with credit card companies, trying to kind of jockey between them. One would offer me zero percent. I would do a balance transfer. I'm able to pay directly on to my principal, not accumulating interest. So knocking out as much consumer debt as possible, knowing what we have coming in, paying yourself first, though, to saving for your own retirement.

Then if you have extra, starting – you talked about a 529. I started that from the time my children were little. Even if you're just putting in 25, 50 dollars a month, it will have that benefit of compounding interest. But raising a family is very expensive. That's for sure.

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FT: It is and so many things we could say on this topic. I would just add that if you have an employer that offers benefits for family leave and families who are adding children into their lives, review those benefits and just know what you may have ahead of you. You might be delightfully surprised. I don't think that's often the case.

But my husband, I always say, he thought he had no family leave for when we had our first child. He was convinced he was he worked for a startup. He thought, “Well, what are the odds?” Well, don't you know, he did ask HR, and he found out he had four weeks of paid leave.

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MO: Oh, great.

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FT: Which I'm telling you, going from thinking you have nothing to a month, that was a good day in our house.

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MO: We're finding more and more employers are offering paternity leave. Yes.

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FT: Yes. I think it's wise if they want to be competitive. So all this to say, review your benefits because if nothing else, it just manages your expectations, allows you to plan better ahead of time. So you know like, “Okay, I have these many weeks or months off that are paid. These many weeks or months that I want to take off that's not paid.” So between now and then, saving or coming up with money to afford that leave is very helpful.

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MO: That's right.

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FT: Okay. Last but not least, Mary, affording a startup. We just talked about it with Amy Porterfield, as I said, knowing when you can like sort of quit your job. There are many factors involved. I recommend people go back and listen to that episode. But in terms of knowing when you can quit your day job to start the business, what do you like to see in people's bank accounts?

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MO: Well, again, with the certified financial planning, we always use those benchmarks. They always say have three to six months of living expenses. I would say if you're going to do **[inaudible 00:29:20]**, I would want to have at least one year's worth of living expenses to cover your living expenses while you're in transition and recreating that new paycheck. That's what would make me feel comfortable.

But then, also going back to what you had talked about, is making sure you have access to credit such as like a HELOC or something like that, trying not to put a lot of money on credit cards because interest rates on those are very, very high. So, again, if you could go in well, obviously, with business, you're going to accrue debt. But as minimal personal debt as possible, that would be important.

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FT: Yes. There are lots of resources for entrepreneurs. You can check your small business development in your town, in your municipality. A lot of those organizations have grants. They have free resources. They have free mentoring. SCORE is a great resource for those starting businesses. They're local, all over the country. They have chapters.

Also, crowdfunding is a huge vehicle for helping these fledgling entrepreneurs. Rather than taking on loans or thinking that it's either going to be like venture capital or bust, maybe you just need some seed money to get you going, like $15,000, $10,000. My friend, Karen Cahn, runs IFundWomen, which is a great platform where, essentially, now they do so much. They have scholarships. They have mentoring programs, coaching programs.

But at the core, it is a crowdfunding platform for women entrepreneurs to get $10 here, $18 there. They do a whole campaign around it, and they get these women launched. It's really, really exciting. I encourage you to look at all these additional resources to help you feel more ready for this, for what is a very risky as – I will speak personally. Risky venture, starting a business. We should – if you've got the urge, you should feed it.

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MO: That's right.

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FT: Mary O'Malley, thank you. Thank you so much for helping us navigate these giant topics, which, like I said, they each merit their own episodes. But we got through it with lots of insights. Thank you.

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MO: Oh, thank you, Farnoosh. I love being on your show, a big fan, and I appreciate the time with you today.

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FT: Everybody, if you would like a free guide to help you set yourself up for financial success today and in the future from Prudential, head over to farnoosh.tv/prudential. I'll see you back here on Monday, and I hope your weekend is So Money.

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