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These Financial Mistakes Can Cost You

By admin

Some financial decisions are made without enough thought given to the long term consequences. TIME – a critical element for any successful long-term financial strategy – can affect different situations quite dramatically. Here are some financial mistakes you should try to avoid:

Mortgage amortized too long:

With lenders offering 30 year amortization periods, it may look attractive to go with a smaller monthly payment to get into a larger house, but the extra interest charges only benefit the lender.

Rick and Jane are contemplating a \$500,000 mortgage on a house. If payments are amortized over 25 years at 5.00% interest, they will pay about \$2,908 per month which totals \$865,373, a whopping \$365,373 in interest. If they pay the mortgage over 30 years instead at the same 5.00% interest rate, their monthly payment will only drop to about \$2,668 per month, but their total payments will balloon to \$951,655, with a total of \$451,655 in interest.

They could take the mortgage at 5.00% over 20 years with a monthly payment of about \$3,285. Rick and Jane would pay about \$783,045 in total with interest representing \$283,045 of this amount. This means an interest savings of about \$168,610 versus the 30 year mortgage.

Carrying a credit card balance:

Credit cards, like Visa and MasterCard, typically charge about 18.00% on outstanding balances. Any new charges made on the card while there is an outstanding balance will attract this high interest charge from the date of purchase. The monthly minimum payment is only 3.00% of the outstanding balance and any remaining balance will continue attracting the high interest charge. If only the minimum payment is made each month, it might take over 19 years to pay off the credit card balance.

For example, a \$5,000 credit card balance, with no new purchases, and only the minimum monthly payment (which is very sneaky because the monthly minimum payment slowly declines as does the balance owing), will take 226 months to pay off in full. Payments will total \$9,798.89, almost DOUBLE what the original purchases were.

Taking money out of an RRSP before retirement:

Jack and Diane had some debts that they thought they should pay off by cashing out some RRSPs. Both age 35, they would have to withdraw \$30,800 to net about \$20,000 after taxes. If they leave the funds in the RRSP until, say, age 65 at 7.50% average annual compound rate of return, they will grow to \$269,652.62. The minimum RRIF payment the first year would be almost \$900.00 per month. They decided to give up some lifestyle expenses instead.

Waiting to start an RRSP:

The longer you wait to start an RRSP, the less you will have to retire on, assuming the same annual deposit throughout. Twins Samantha and Tabatha each started RRSP's with \$5,000 annual deposits at 7.50% average annual compound rate of return. Tabatha started at age 21 and will make deposits right up until she turns age 65. Her funds will grow to \$1,544,835. Samantha waited until she was 31 to start. Her funds will only grow to \$717,798.17. For Samantha to accumulate the same amount as her sister, she would have to deposit \$10,836.41 per year.

**Fictional characters for illustrative purposes only.*

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