

# How to be Smarter About Buying Cars

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Much of the personal finance industry is focused on investing, but it's also important to know how to be a better saver and spender. For many people, being disciplined about saving and sticking to a budget is just as important as investing.

One of the most often overlooked aspects of personal finance is how to get more happiness out of your spending, and Norbert Schwarz at the University of Michigan and Jing Xu at Peking University have conducted research that can help you be a smarter car buyer.

## How Important is a Car Purchase?

It's no secret that people like toys, and in many ways the car is the ultimate toy. Buying a car is a much more important financial decision than most toy purchases, however, because aside from buying a home, a car is the biggest purchase many people make. And unlike a home, which will appreciate in value over time, a car is a depreciating asset.

Traditional economics and the life cycle hypothesis hold that people rationally balance current consumption against the importance of saving for the future in order to even out consumption over their entire lifetime. Unfortunately, the empirical evidence clearly discredits this hypothesis. According to the most recent Retirement Confidence Survey, most Americans have less than \$25,000 in retirement savings. That's less than the average price of new cars in the U.S., which is more than \$31,000 according to Kelley Blue Book. There's just no doubt that too many people spend too much on cars.

## Will an Expensive Car Make You Happy?

What makes an expensive car "worth" the money? The most common justification for owning an expensive car is that it makes you happy. But will you actually be happier with an expensive car?

Students at the University of Michigan were asked to predict how much they would like driving a BMW, a Honda Accord, and a Ford Escort. Not surprisingly, students predicted that they would enjoy driving the most expensive car (BMW) the most and the least expensive car (Ford Escort) the least.

The next part of the study involved a web survey and a survey of University of Michigan faculty and staff. First the participants were asked which car they drive, and then asked how they usually feel while driving it. Kelley Blue Book values were used as approximations of "car quality" to see whether or not "car quality" would affect the emotions reported by drivers. The results were actually consistent with the students' predictions, as drivers reported more positive emotions when driving more expensive cars.

The most important part of the study came next. University of Michigan staff and faculty were asked how they felt during their most recent commute; web survey participants were asked how they felt during their most recent drive longer than 20 minutes and the nature of the drive. After they reported their feelings they were asked what car they drove. The results may surprise you, as "car quality" was found to be unrelated to the drivers' experience. When the questions were framed in this manner, economy car drivers were just as satisfied as luxury car drivers.

So what's the point of this study? The car only makes a difference if it's on the driver's mind. When the emphasis is first placed on the car, and not the driving experience, people think about the car when formulating answers. Actual driving experiences, however, are very different. Most people are not focused on the car when they are driving, instead they're focused on routine matters that relate to everyday life. The research also indicates that while driver's feelings don't depend on the car they're driving, they do depend

on the type of drive (e.g. driving to a leisure event vs. commuting to work). Think about driving an economy car on vacation versus driving a luxury car to work, what drive would make you happier?

### **Driving for Fun is Different**

Another group of participants were asked how they felt the last time they drove their car just for fun, and only respondents that had done so within the past week were included. This group reported more positive feelings when driving more expensive cars, because driving for fun focuses attention on the car. Most of the time, however, drivers are thinking about everyday matters when driving. When was the last time you drove just for fun?

A new car can provide happiness when it's new enough to make the driver pay attention to the car, but once it becomes familiar people then think about other things while driving. Of course an old car can cause concern if reliability becomes an issue, but the fact of the matter is that drivers of both expensive and inexpensive cars don't typically focus on their cars unless they're driving for fun.<sup>1</sup>

### **Smart Car Buying Tips**

- Make a conscious effort to buy an inexpensive car. The odds are that you'll be just as happy driving it as you'd be driving an expensive one. And the resulting increase to your savings may elevate your overall happiness in the long run.
- If you're lucky enough to be able to afford an expensive car (e.g. your retirement plan is overfunded and you've met all your other important financial goals), make the most of it by making a point to drive it just for fun on a regular basis. That could mean a leisurely cruise down the boulevard, a fun off-road expedition, or even a day at an organized performance driving event.
- Buy a used car. New cars can depreciate as much as 30% in the first year. If you're not comfortable buying a used car from a private buyer then consider buying a dealer certified used car with a warranty.
- Pay cash and avoid car loans if possible. If you have to take out a loan, make sure it's for no longer than 4 years with at least a 20% down payment. And make sure that the loan payment plus insurance is no more than 10% of your gross pay.
- Don't lease a car because you can't afford loan payments on that car. If you're in that situation then the reality is that you can't afford the car. Repeatedly leasing cars means that you're continuously paying for the first few years of a car's life, which are the most expensive because of depreciation.
- Keep your car for a long time and don't be afraid of repairs. Try to hang onto a car for more than 10 years. Cars are increasingly reliable, and car repairs are usually a lot cheaper than car payments. Only consider selling your car if an auto repair costs more than half of the trade-in value.<sup>2</sup>

Remember that buying a car does not have to be an emotional decision. The more logical your approach, the better off you'll be. If you need help sticking to a budget or making sensible spending decisions, consider finding a CERTIFIED FINANCIAL PLANNER™ professional from the Financial Planning Association® to help you.

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<sup>1</sup> Schwarz, N., & Xu, J., Why don't we learn from poor choices? The consistency of expectation, choice, and memory clouds the lessons of experience, *Journal of Consumer Psychology* (2011), doi:10.1016/j.jcps.2011.02.006

<sup>2</sup> Gregory Karp, Driving down car debt commitment, *Chicago Tribune*, April 20, 2013