



Extension News Column

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We've been "pinching pennies" for a few weeks now and I thought it might be a good idea to talk about debt—how you get in and how you get out. Most of us don't have much problem getting in, but it is much harder to get out of debt.

If you watch the news or read the newspaper, you are bombarded with the statistics that tell us how much collective debt we all have. It is a considerable amount, but debt is necessary for many of us. We weren't born with a trust fund or unlimited monetary resources—so in order to get what we need, we have debt. The way you handle that debt, however, is telling. It can be a tool or a trap. We just need to make sure we are using it as a tool.

Debt may be inevitable, but it is important to remember that there are different types of debt—both good and bad. Good debt helps you get the things you need such as a house, an education, or even a car. Bad debt is debt that doesn't add to the balance sheet. Good debt might be buying a car for transportation, bad debt might be buying a Porsche or charging a meal that we have no way to pay for at the end of the month.

Sometimes it helps to keep a visual reminder of your debt. Make a giant progress bar that has the whole debt on one side and 0 on the other. Color in a little of the bar each time to pay some on the debt. Keep it in a place where you can see it often, and fill it in. Keep your eyes on the progress and you'll feel you are getting somewhere.

Once a year, I always set down and tally up the amount of our household debt. I usually do this on July 1—but pick whatever date you want. I write down the total amounts we owe on that date, and how I'm going to pay them off. I write what I'm paying each month and what is the payoff date. I tape it inside the cabinet door right over the top of last year's list. Again, it is a visual reminder of the plan we have in place. It is also much easier to remember what we are working toward when you see it in black and white, and much easier to resist the urge to spend money.

I have designed a plan to get rid of debt in my household. Do you have one? Everyone needs a plan to get out of debt. One effective way to pay off debt is to design a "debt snowball." This is an effective way to pay off debt quickly.

First, sit down and write out everything you owe; every credit card, installment loan, and education loan. Then, plot what you are going to pay off and in what order. I always suggest that people pay off those debts that carry the highest interest rate—in most cases these are credit cards.

Now, take a look at your budget. See where you can find a few extra dollars and dedicate that to paying off your debt. For instance, let's say that you can find an extra \$50 to pay on debt. Continue to pay the minimum payment on all your debts, but pay this extra \$50 on the debt that has the highest interest rate. You are snowballing that debt until it is gone. Once that debt is paid off, you move the extra \$50 plus the minimum payment on the first debt to help pay off the second debt. Before long, all these debts will be paid off.

Just in case you think \$50 won't make a difference, let's look at the numbers. Say you have \$5000 in credit card debt at a rate of 15%. If you pay \$100 per month, it will take you 79 months (6.6 years) to pay it off. If you add your extra \$50 to this amount and pay \$150 each month, the bill will be paid of in only 43 months (3.6 years). This will save you 3 years and almost \$1500 in credit charges.

The numbers are bigger on your house loan, but it works the same. A \$200,000 house can be financed at 6.5% for 30 years with a payment of \$1264 (not including taxes and insurance). By adding the same \$50 to the payment, we can pay for that house in 26 years while saving almost \$48,000. Those small amounts can really add up. You are spending an additional \$15,600 at \$50 per month, but the savings are considerably more.

Take stock of what you owe, make a plan, and stick by it. You, too, can be debt free!