Prudent Debt Management

By Richard L. Miller
Chartered Financial Consultant

The life-long goal of many people is to become completely debt-free. As strange as it may sound, this may be the **very** reason why some people always seem to be in debt and never manage to begin accumulating capital of their own. Those who pay as much as possible towards their debts sometimes fail to set money aside for future expenses that will inevitably occur. Just as the end of current debt is in sight, some people are forced to acquire **new** debt to pay for necessary purchases since they have failed to accumulate adequate funds to pay for them.

► **Restructure Current Debt** – The best solution may be to consolidate or restructure current debt to achieve the lowest possible interest rate and a monthly payment low enough to allow you to begin ***saving*** money on a regular basis. It is important to establish a systematic program so that the funds are set aside with the same discipline required for paying any other bill. Because some people become more motivated in watching their savings grow than they do in watching their debt decrease, they may be more apt to avoid frivolous spending in order to build their savings even further.

As logical as this may sound, people sometimes oppose refinancing their debt to achieve lower payments since this normally means stretching out the **term** of their debt and thus incurring more **total** interest costs. What they fail to recognize is that if the money they **save** in monthly payments is invested, the interest they **earn** may equal or exceed the extra interest they **pay** by stretching the debt out.

Accelerating payments on **high** interest debt, on the other hand is usually a good idea since it may be difficult to safely invest at an equivalent rate. However, if the debt can be refinanced at a **lower** rate, it may be wise to make lower payments and set aside the monthly savings. The amount you owe is **less** important than your total **net worth**. Someone, for example, that owes $20,000 in debt and has accumulated $100,000 in savings is in a better position than an individual who is debt-free but has accumulated only $50,000 in savings.

There are a number of methods available to restructure debt which may be appropriate depending upon individual circumstances.

► **Home Refinancing** – If new mortgage rates are even slightly less than your present home loan rates, it may make sense to refinance, especially if you now have a shorter term loan and expect to stay in your home for a number of years. If you currently owe less than 80% of your home's appraised value, you may be able to refinance for **more** than your present loan amount and receive cash back to pay off other debt.

► **Home Equity Lines** – If your first mortgage rate is competitive but you have available equity, establishing a home equity line of credit to obtain cash to pay off other debt is one of the best ways to lower interest cost and monthly payments. If your total mortgage debt does not exceed the fair market value of your home, the interest paid on up to $100,000 of home equity debt may be fully tax deductible. A regular second mortgage loan may also be a desirable alternative.

► **Auto Refinancing** – If new auto rates are less than you currently pay, it may make sense to refinance your auto loan for the maximum available over the longest possible term, unless you intend to trade vehicles soon. Your monthly payments can also be reduced by canceling all credit term insurance, which may be much more expensive than privately owned coverage.

► **Low Interest Credit Cards** – High interest credit card debt can often be transferred to cards which charge much lower interest rates. The monthly payback rate can be set at whatever level you wish by charging normal purchases each month and then paying for the purchases in full.

► **Apply Cash From Savings** – Some people have more cash than necessary earning passbook interest rates and at the same time are paying on high interest debt. It usually makes more sense to withdraw the cash to pay off the debt and then invest the monthly savings in potentially higher yielding investments.