ALASKA HIGHWAY NEWS

Smart Money: Controlling your debt

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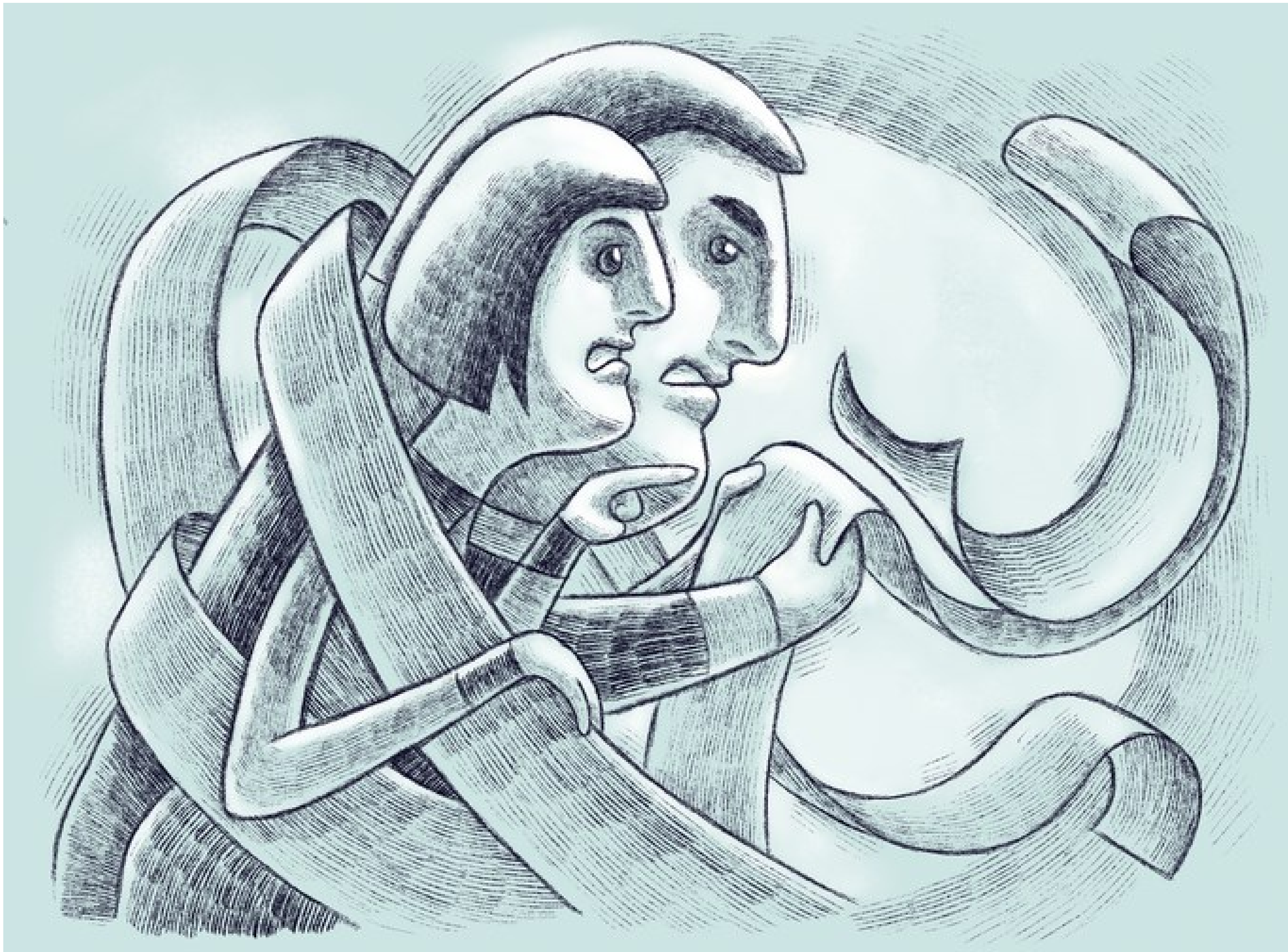

Brad Brain: "If you do carry bad debt, getting that under control will often be your priority. It's hard to make forward progress with your finances if your cash flow is restricted by too many loan payments, and the math of trying to increase your net worth when you have too much interest expense is usually problematic." | Getty Images

Debt is a fact of life. Sooner or later you are going to borrow money, and that's not necessarily a bad thing. Borrowing money allows us to do the things that we want quicker than we otherwise would.

But, like many things in life that give us pleasure, you will want to be in control of your debt. Because debt can ruin you.

There are different types of debt, and some debt might even be considered as good debt. The best possible debt will be at a low interest rate, have tax advantages, and the money will be used to acquire an asset that appreciates in value. An example is an RRSP loan. These are available at low interest rates, you can deduct your RRSP contribution from your taxable income, and the RRSP should grow over time.

You don't necessarily need all three conditions to be present for debt to be worthwhile. A mortgage is an example. The interest rate will be low, and real estate often increases in value. Usually you can't deduct the mortgage interest on your principle residence from your taxes, but we can't always get everything we want.

But people don't usually get into trouble with good debt. It's the bad debt that we need to watch out for. The worst debt will be at a high interest rate, with no tax relief, and used to buy something that depreciates in value. There are an abundance of examples of bad debt, including buying stuff you don't really need on a credit card that you don't pay off at the end of the month. Do what you can to avoid bad debt in the first place.

Regardless of the type of debt, having a debt paydown strategy is worthwhile. The quicker you extinguish your debt the less interest you pay, and the sooner you can use the money you are spending on loan payments for something more interesting.

There are some relatively painless mortgage paydown strategies that are worth consideration. Going biweekly with your mortgage payments, or setting your mortgage payment a little higher than the minimum, or making a lump sum payment against your mortgage can shave years of your mortgage and save you thousands of dollars. Speak to your lender about your options for paying off your mortgage quicker.

If you do carry bad debt, getting that under control will often be your priority. It's hard to make forward progress with your finances if your cash flow is restricted by too many loan payments, and the math of trying to increase your net worth when you have too much interest expense is usually problematic.

If you have credit cards that you never seem to be able to pay off, talk to your financial institution about a consolidation loan. You may be able to significantly reduce your interest rate and come out with more manageable cash flow.

A word of warning though. A consolidation loan is a rescue, not a free pass. If you take a loan out to pay off your credit cards, and then you go out and rack up your credit cards again, that's a problem.

Here are some ideas if you don't know where to start. Focusing on paying off your bad debt first, then work on paying off your good debt is often the optimal strategy.

Sometimes we need to break things down into manageable chunks though. If trying to tackle all the debt simultaneously is too much and there is no obvious first choice as to which debt to prioritize, consider the Snowball Strategy.

The Snowball Strategy involves concentrating on your smallest debt first and just making the minimum payment on everything else. Once you pay off your smallest debt in full, then you move on and focus on your next smallest debt. The idea here is that you are trying to reduce the number of debts you have, rather than the interest expense or the time it takes to pay each one off.

The prudent use of debt can enhance our lives. But when used recklessly debt can be the anchor that drags us down. Control your debt lest it control you.

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