Lesson 3

Avoiding Debt

The rich rule over the poor,
and the borrower is servant to the lender.
Proverbs 22:7

In Lesson 2 we learned that the financial principle for building wealth is the power of compound interest. You do not have to save a million dollars to become a millionaire. Time, discipline, and patience build wealth.

If this principle holds true in building wealth for you, do you think the reverse could be true? Every time you borrow money, you are putting the principle of compound interest to work not *for* you but *against* you—and in favor of your creditor. That's why borrowing is terrific for the banking and finance industry but horrible for you! Our attitude toward debt can become a major barrier to building wealth.

Nowhere does the Bible condemn debt, but it does warn us against not repaying our debts.

The wicked borrow
and do not repay.
Psalm 37:21a

Let no debt remain outstanding,
except the continuing debt to love one another.
Romans 13:8a

Debt itself is not a sin. However, it may manifest itself as a symptom of sin—greed, impatience, over-indulgence, or lack of self discipline. Debt can create financial bondage. **Proverbs 22:7** states: "The rich rule over the poor, and the borrower is servant to the lender." Benjamin Franklin once said, "Creditors have better memories than debtors." Jesus said the same thing during his ministry on earth.

I tell you the truth, you will not get out
until you have paid the last penny.
Matthew 5:26

One of the greatest plagues on our nation has been the credit card. Americans are drowning in credit card debt. In 1968, consumers owed $8 billion on their credit cards. In 2010 the U.S. Census Bureau reported that Americans had over $886 billion in credit card debt, and that figure is expected to rise to $1.177 trillion in 2011. About one-third of Americans do not own credit cards; but of those who do, only 54 percent pay the balance in full each month. Over 2 million American homes carry more than $20,000 in credit card debt.[15]

For the Lord your God will bless you as He has promised you,
and you will lend to many nations, but you will not borrow;
and you will rule over many nations, but they will not rule over you.
Deuteronomy 15:6

There are varying interest rates on credit cards; but probably the highest rates can be found on retail credit cards, which currently range from 21 to 29 percent. Selling merchandise is just a sideline for Sears. Sears makes far more money on credit cards than it does on the sale of its merchandise; financing purchases is a major source of income for other retailers, too. The findings of research on credit card use have been replicated many times and always with the same results: families who use credit cards, even if they avoid finance charges by paying the full balance each month, spend 35 to 50 percent more for their purchases when they use plastic. Paying with cash tends to limit impulse buying.

Have you "discovered" why the Discover Card prompts you at the cash register with the question, "Do you want cash back?" When people tell the cashier "Sure, give me $20!" have they considered that the APR (annual percentage rate) on cash advances is much higher than on purchases, and Discover charges an additional 5 percent fee for cash advances. Discover Card's own web site states: "Typically, the card issuer charges a cash advance fee for the transaction and begins charging interest immediately."[16] And just who is the "card issuer"? Discover, of course!

Here's a suggestion for limiting the use of your credit card. Find an old ice cube tray, fill it with water, add your credit card, then freeze it. If you find a terrific buy, you'll have to go home, thaw out your credit card, and return to the store to make your purchase. By then you will have had enough time to consider whether this was really a wise purchase after all. But for some of us, freezing our credit cards is still not a tough enough measure. Consider these words of Jesus:

If your hand causes you to sin, cut it off.
It is better for you to enter life maimed than with two
hands to go into hell, where the fire never goes out.
Mark 9:43

[15]HoffmanBrinker.com, June 29, 2011.
[16]DiscoverCard.com, June 29, 2011.

Rather than cutting your hands off, I suggest you just perform plastic surgery. Cut your credit cards up! You will then have two other options. You can use cash or carry a debit card. Virtually everyone accepts debit cards, even hotels and most car rental companies. Check with the company issuing your debit card to make sure it is offered the same protections as its credit card in case of theft or fraud. Then run your debit card as a credit transaction without using the PIN number.

Let's look at how carrying a balance on a credit card can adversely affect your wealth. Assume you charge $1,000 on your favorite retail credit card, never use it again, but only pay the minimum balance each month. How long would it take to pay the balance? Of course, it depends on the APR and the percentage of the balance considered a minimum payment. Some credit cards ask for only 1 percent of the balance as a minimum payment. How long would it take to pay a balance of $1,000 at 21 percent interest with a minimum payment of 1 percent? You probably won't live that long!

Credit Card Balance	$1,000.00
Interest Rate	21%
Minimum Payment	$10.00
Years to Payoff	50.08
Total Interest Paid	$205,758.35

But there's also something else to consider: your opportunity cost. By paying your lender over two hundred thousand dollars in interest payments, you have lost the opportunity to invest that money. Assume that you paid the entire balance when you received the statement and invested the interest you would have paid each month at a 7 percent rate of return. At the credit card's payoff date, you would have earned $1,887,712.36 in compounded interest.

Credit card companies employ different methods for determining finance charges, and their computational methods are not designed to make it easy for the consumer to interpret. The outstanding balance may be calculated by these different methods: (1) over one billing cycle or two; (2) using the adjusted balance, the average daily balance, or the previous balance; (3) including or excluding new purchases on the balance.

The four most common methods for calculating finance charges are the (1) average daily balance, (2) daily balance, (3) two-cycle balance, and (4) previous balance. A number of years ago, Bank Card Holders conducted a study of different calculation methods for computing finance charges using the following data: With a 19.8 percent APR, you charge $1,000 and make only the minimum payment. In the following month, you charge another $1,000 and then pay your balance in full. Listed below are the finance charges, which vary according to the calculation method your credit card company uses.

CALCULATING FINANCE CHARGES ON CREDIT CARDS	
Average daily balance excluding new purchases	$16.50
Average daily balance including new purchases	$33.00
Two-cycle average daily balance excluding new purchases	$32.80
Two-cycle average daily balance including new purchases	$49.05

How is the Discover Card able to give rebates on your purchases each month? They are using the two-cycle method of computing interest! The only way you'll ever win with such a deal is to pay off your charges at the end of every month. And if you really want to win the money game, don't use credit cards. You will spend less when you pay cash for your purchases.

Before you sign up for a credit card, look at the Schumer Box on the back of the application. The Fair Credit and Charge Card Disclosure Act of 1988 forces companies offering credit cards to disclose all relevant information to consumers. The Schumer Box must show the Annual Percentage Rate (APR), the amount (if any) of the annual fee, how finance charges are calculated, and how late fees are assessed.

As parents, we need to consider the lessons we are teaching our children about debt. Ask yourself: Am I teaching my teenager to be responsible or irresponsible when I give him a credit card? Credit card companies target teenagers and college students more than any other age groups. Forty-two percent of college freshmen have a credit card and owe an average of $1,500. By the time college students graduate and before they have jobs, 80 percent of them have credit cards with an average debt of $2,850.[17]

Parents, when you co-sign with your teenager to buy a car, you have effectively said, "If you can't pay for something, buy it anyway." The Bible warns us not to co-sign **(Proverbs 22:26-27; Proverbs 6:1-4; Proverbs 11:15; Proverbs 17:18).**

Do not be a man who strikes hands in pledge
or puts up security for debts;
if you lack the means to pay,
your very bed will be snatched from under you.
Proverbs 22:26-27

If you co-sign a loan for a car, the lender won't contact you when the loan is paid late every month, but your credit will be damaged each month. The lender also won't contact you if the car is repossessed, but you will have a repo on your credit report.[18]

One of the most significant ways Americans could build wealth is by changing their view of one of the necessities of life: the automobile. Millionaires did not become millionaires by driving expensive cars. The average millionaire bought his car used and paid cash for it. Consider buying a reliable used vehicle less than three years old instead of the latest model. While you are driving that car, pay yourself a car payment each month by saving what you would have spent on the new car. By the time you are ready to purchase another car, you will have the cash ready and available.

When I look in the parking lot at my home congregation, I see all types of vehicles. Many are late model SUVs with all the bells and whistles. But then there are the cars of the smart folks I know. The wealthiest person in my congregation drives an older model vehicle, and I have several close friends

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[17]Consumer Credit Counseling Services, www.cccsstl.org/lifeandcredit/creditCard.asp, July 1, 2011.
[18]Ramsey, David L. *The Total Money Makeover,* Thomas Nelson, Inc., 2009.

who have never financed a car or never bought a new one. One of them typically drives Cadillacs and Lincolns and currently has a beautiful Lincoln Navigator, but it was purchased used. My son's father-in-law takes excellent care of his attractive Chevy Tahoe, which has almost 300,000 miles on it. These people are not "average" Americans.

The "average" American family keeps a car payment for life, and the average payment on an automobile is $495 per month. What if, instead of making that car payment, you saved $495 a month from age 25 to age 65, a normal working lifetime? Invested in a mutual fund averaging 12 percent (the 80-year stock market average), you would have $5,881,799.14 at age 65.[19] Do you still want to buy a new car and make payments? You are *not* what you drive!

A number of years ago a young man I know who worked at a Toyota dealership in Atlanta was moved from his position as top salesman to director of finance. At the time I remember thinking that was odd; I assumed that the top salesman ought to be in the car lot. I now understand why he was promoted to finance: The average new car generates only $82 profit for the dealer, but a car dealership that sells financing makes $775 per car. If they can get you to lease the car, then the dealer sells the lease to a local bank, GMAC, Ford Motor Credit, or similar financing agency and makes an average of $1,300 per car. So a car dealer makes money in the finance office, not on the car lot.[20]

Always negotiate a loan just like you do the sale price. Another important point to remember is never secure a loan from the seller. You may find yourself negotiating a great price on your new car only to find that you gave away the farm on the loan. In Lesson 9, we will discuss some more "do's and don'ts" of purchasing automobiles.

Transportation is one of those necessities of life—right up there with the Big Three—food, clothing, and shelter. However, when we see the true cost of an automobile loan, then driving an older model for a while longer may be much more appealing. Also, when you drive your beautiful new car home, it has just *depreciated in value thousands of dollars—and as much as 30 percent the first year.* So, if you want to reduce the cost of transportation, consider these three ways: pay cash, buy used vehicles, and drive your car longer.

Not many people pay cash for their homes, but it's certainly not impossible. By living below their means for a few years, many people could save enough to pay cash for a house. Mortgage loans are usually considered a sounder investment than other types of loans because (1) A house provides a place to live; (2) Houses usually appreciate in value; and (3) Families receive an income tax deduction for interest paid on a home mortgage. But these advantages may really be disadvantages: (1) Families that have mortgage debt severely restrict their liquidity, which is the amount of assets in cash reserves; (2) Houses can and do depreciate, and sometimes families get stuck with a mortgage that is greater than the value of the home; and (3) An income tax deduction will never be as great as being debt free. For example, if your interest payments are $10,000 per year and you are in a 30 percent income tax bracket, you will save $3,000 in taxes. Which is better—to pay $7,000 in interest ($10,000 less the tax deduction) or to pay $3,000 to the IRS?

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[19]Ramsey, David L. *The Total Money Makeover,* Thomas Nelson, Inc., 2009.
[20]Ibid.

All too often families mortgage their future by buying more house than they can afford, which severely restricts their available cash. The real estate and banking industries have exacerbated this problem by encouraging families to spend from one-fourth to one-third of their monthly incomes for mortgage payments. A family should not spend more than one-fourth of their *after-tax* income for a mortgage payment.

If you do take out a mortgage, go with a 15-year loan. There is an enormous difference in interest paid on a 30-year mortgage versus a 15-year mortgage. For example, the total payout on a $200,000 mortgage at 7 percent interest for 30 years is $479,018, but the total payout on the same loan for 15 years is $323,578, or a savings in interest of $155,440. The difference in the payments is $467. If you already have a 30-year mortgage, consider paying extra on the principal each month. You will see it paid off quickly since mortgages are front-loaded with interest. Unfortunately, only 3 percent of people ever pay extra on the principal of their house.

One of the most popular types of loans today is the HEL—Home Equity Loan. It has two advantages: (1) The interest is usually tax deductible since it is considered a second mortgage, and (2) Interest rates are lower than other types of loans. However, it is also dangerous. If you are unable to make payments on the second mortgage, your creditor could foreclose on you. People who lose their homes in this way also lose the equity they have spent years building on their first mortgage.

Another type of loan that should be avoided is the debt consolidation loan. This type of loan can be enticing when a family has difficulty paying all the bills. Unfortunately, it is very costly and usually leads to even more debt. The idea behind it is to consolidate bills into one low monthly payment, which can be much easier to handle. However, when debts are stretched over a longer period of time, the interest is much greater. And when the payments have been reduced, most people return to their former overspending habits.

A far better plan is to prepare a list of all debts, the total payoff on each, and the amount and number of payments. (See page 31 at the end of this lesson for a Debt Payoff form.) Then start paying off those debts beginning with either the smallest loans or the highest interest loans. Paying off the small loans first will provide you with quick rewards for your efforts and will motivate you to stick with the plan. If you have been behind in your payments, talk to your creditors and show them how you will pay off your debt. Pay something on each debt every month so that your creditors will know you are serious. The worst thing you can do is to ignore your creditors.

It is important that we maintain a superior credit rating for several reasons. First, it’s a matter of our integrity and our reputation. Second, sometimes employers use credit checks to draw conclusions about our character. Also, we must maintain a good credit standing to obtain credit; and the better your credit rating, the lower the interest rate you will be offered.

Unless you have ever been hounded by creditors, you cannot appreciate how truly miserable they can make life for you. A close relative of mine, who eventually had to declare bankruptcy, described to me what it was like having continuous telephone calls from creditors. One representative from a collection agency suggested she earn the $40 she owed by selling a pint of her blood! An author who experienced severe financial problems described the day his wife received a call from a collector, who asked her why she would live with a man who wouldn't pay his bills.

Many years ago I opened my mailbox to discover a letter with this inscription on the envelope: "You have 24 hours." What could possibly happen in 24 hours? After calling the phone number listed on the enclosed letter, I discovered that approximately seven years earlier I had charged about fifty dollars and never paid the bill. I had used an unsolicited credit card, which I had carried in my wallet for several years, to purchase a lawn mower. The bill never arrived because it was sent to our old address. Even though our new address had been published in the telephone book and a local city directory, the department store had sent almost a hundred bills to the old address, and all the bills had been returned because the post office could not forward them. After seven years the finance charges totaled as much as the cost of the mower, but I was forced to pay the entire bill or be threatened with having my credit rating ruined.

I learned another lesson several years later when I charged $30 on an Atlanta department store credit card. I paid the entire bill when it came. Apparently, my payment arrived too late and a second statement was sent, which included a finance charge of 50 cents. Not wanting to be bothered with writing a check for 50 cents, I threw the bill in the trash. Two years later I received a letter from an oil company explaining why they could not offer me the credit card I had requested. After examining the records at our local credit bureau, I discovered that my husband and I both had superior ratings from all of our creditors except one—who still carried an unpaid balance for a few cents.

There are five C's of credit used by lenders to determine your credit worthiness: Character, Capacity, Capital, Conditions, and Collateral.

Character	Your reputation as determined by your financial history
Capacity	Your ability to repay
Capital	Your assets
Conditions	The intended purpose of the loan and/or the local economic climate
Collateral	Cash or assets pledged to secure the loan

A credit bureau is a company that keeps credit history information about consumers and sells it to lenders. There are four types of information maintained by credit bureaus: (1) your personal identification, such as your name, telephone numbers, current and previous addresses and employers; (2) the credit history of your payments to all creditors; (3) public records, such as tax liens, court judgments, and bankruptcies; and (4) inquiries about your credit. Credit bureaus compile information, but they do not interpret that information. By federal law, you may request a free credit report annually. Another type of credit information is a credit score, called the FICO score, which is a number between 300 and 900 that represents your credit worthiness. Most people's FICO score is between 600 and 800. There are three major credit bureaus in the U.S. Most lenders provide information to all three.

EQUIFAX	equifax.com	1-800-685-1111
EXPERIAN	experian.com	1-888-397-3742
TRANS UNION	transunion.com	1-800-888-4213

Bad credit will be removed from your credit report after seven years unless you have a Chapter 7 bankruptcy, which will not disappear for ten years. Chapter 7 bankruptcy is a liquidation or total bankruptcy; a Chapter 13 bankruptcy reorganizes debt with a structured repayment plan.

On the following page are Seven Simple Steps to Sensible Stewardship. Implement these steps into your financial life, and you will see how much easier it will be to save for the future.

Debt mortgages the future. When we understand the true cost of debt, it is not hard to see that borrowing is terrible for us. We cannot expect to build wealth when we are financially strapped with monthly payments on the mortgage, the student loan, the car, the home equity loan, and the credit cards. How much could you save if you had no payments? Becoming debt free is not contingent upon your income. It's all about changing your behavior and staying focused on the goal.

Get out of debt and free yourself!

Watch out! Be on your guard against all
kinds of greed; a man's life does not consist
in the abundance of his possessions.
Luke 12:15

Seven Simple Steps to Sensible Stewardship

Step 1 *Give* of Your Abundance!

Step 2 *Freeze* Your Credit Cards!

Step 3 *Stop* Paying Interest!

Step 4 *Save* on a Regular Basis!

Step 5 *Purchase* Insurance Wisely!

Step 6 *Quit* Buying New Cars!

Step 7 *Take* Your Time!

SCRIPTURES TO LOOK UP THIS WEEK

Directions: Look up the following scriptures and write a summary for each.

I Timothy 6:6-9 ____
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II Kings 4:1-7 ____
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Ecclesiastes 5:5 ____
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Proverbs 6:1-2 ____
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Luke 12:25-34 ____
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Proverbs 17:18 ____
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D EB T   P A Y O F F

DATE _______________

Directions: In the first column, make a list of all creditors either in order of the smallest debts to the largest debts OR the highest interest debts to the lowest interest debts. Remember that you will most likely stick with your plan if you have some quick rewards by paying off the smallest debts first. In the second column, list the total owed for each debt. In the third column, list the monthly payment for each debt. In the fourth column, list the number of payments remaining on each debt. In the fifth column, list the *cumulative* total of payments owed by adding the total owed to a creditor to the previous cumulative total. Make a new Debt Payoff form each time you pay off a debt.

CREDITOR	TOTAL OWED	PAYMENT	NO. PAYMENTS REMAINING	CUMULATIVE TOTAL