



## **Good Debt, Bad Debt**

Last week, we discussed the importance of starting a savings habit as early as possible. One factor which usually prevents us from doing this is our use of debt. Because it is so accessible, people tend to use it without weighing its pros and cons. This week, we discuss the advantages and disadvantages of debt.

### **Debt—The Good Slave**

It has been said that “debt can be a good slave but a bad master”. We all have used some form of debt, or credit as we say locally, at some point in time. Although debt allows us to splurge and buy luxuries, it can also facilitate purchasing necessities. Imagine trying to buy a house without the use of a mortgage. The average middle class family would not be able to do so. How would you face the challenge of saving to buy an item which increases annually? You may have to save thousands of dollars and only be able to acquire your home upon retirement.

It makes better sense to take a mortgage. You enjoy the benefits of the home while paying for it, knowing that the price does not change. Barring no defaults on your part, the house will become yours long before retirement. Here we see debt being used for good. Debt can also be used to consolidate or refinance outstanding costs that we have incurred. For example, if you have purchased several items separately on hire purchase, it makes better financial sense to take a loan for those items thus consolidating your debt. This results in less money owed as the interest rates would be lower and the repayment may even be lower than the previous payments combined.

### **Debt—The Bad Master**

Debt can also have a dark side and this is usually because of its improper use. It is not uncommon to find people with more than one maxed out credit card making minimum payments on their balances. The interest rates on these cards are usually high so it is always wise to try to pay off all balances. Additionally, making the minimum payment is not sufficient to pay off the card within a respectable period of time. Therefore, consider the following when using debt:

- Do not use one credit card to pay off another.
- Do not use credit cards to finance long term debts.
- Use debt for luxury items sparingly. You may need a car but it need not be a Porsche!

Most financial institutions state that one’s debt service ratio (debt to monthly income) should not be above 45%, a wise guideline. However, even that debt service ratio can

cause financial strain. For example, someone may think that a loan repayment of \$1700.00 for a SUV is manageable but there are additional costs to owning that vehicle. Fuel costs for the vehicle may exceed \$500.00 monthly, not to mention servicing. This is why sometimes loans are not granted. Loans officers may feel that in the long run, the debt can become a burden to the customer.

We believe that debt is necessary; it is our use of it that creates problems. Without debt, there are many things that would be out of our reach—our dream of owning a home or a university education for our children. So debt can be a good slave but only if we are responsible masters and that decision is ours.