How To

Bust Out of the Debt Cycle

God's Money MATTERS

A simple 7 Step System to Kill Debt and Create An Investment Portfolio Without Having to Come Up With More Money in Your Budget.

Firstly, let's deal with...

The Five Debt Destroying Tips That The Banks Don't Want You To Know

1. Debt Consolidation

By consolidating personal/consumer and credit card debt into your mortgage it turns a repayment of years into decades. Many advisers and mortgage brokers will recommend that you take this action but it can be a real trap. Deal with the real problem of overspending and get a budget in place so that the symptoms don't return in the future.

2. Set A Shorter Loan Life

Many banks today offer 30 year mortgages, which are supposedly designed to help with new home buyers affordability however it also serves the banks as it keeps people in debt longer. A much better strategy is to work out how much you can afford (push yourself a little), then calculate how long the term of the loan will be with this repayment amount, and set the loan term accordingly - with a small buffer. For example, if the repayments equal a loan repayment period of 18 years, set the loan term to, say, 20 years. This will provide the imbedded discipline to pay the loan off earlier and could save you tens of thousands of dollars.

3. Pay Off Your Credit Card, And Do Some "Plastic Surgery"

Credit card points never made anyone rich (except maybe the banks). Get off the dependency of a credit card - even if you pay it off every month, as it is too easy to fall prey to. Research shows that those who use credit cards spend more than those who use cash. Do the plastic surgery and cut the credit card up. Use a Debit Card instead and let the idea of building credit card points go!

4. Sophisticated = Expensive: Use A Simple Mortgage Product

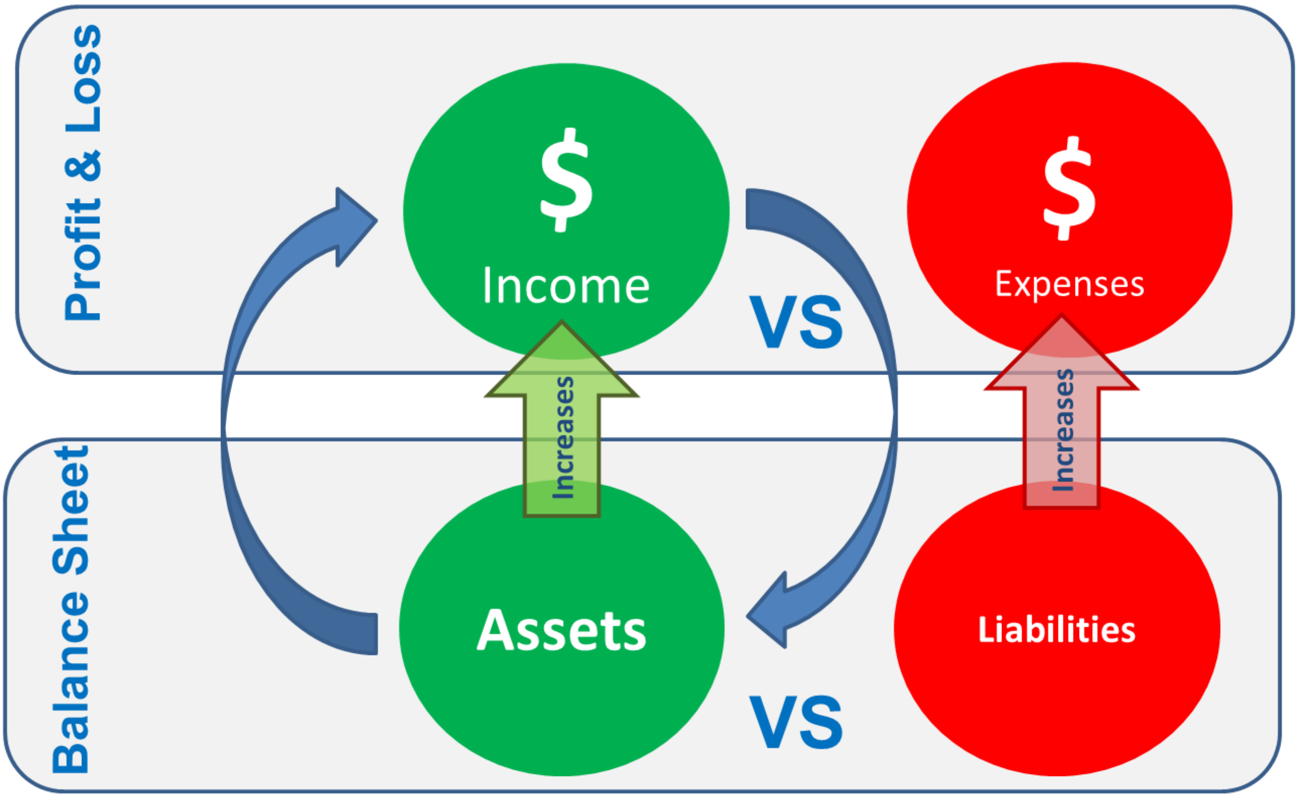
A basic Principle and Interest home loan often has much cheaper fees and a lower interest rate. Home loans with fancy facilities are designed by banks to keep you in debt longer. It is a well-known fact that redraw facilities extend the life of a traditional home loan due to lack of discipline which means that you could be paying thousands or tens of thousands of dollars in extra loan and interest repayments.

5. Don't Always Look To Pay Off The Highest Interest Rate First

Debt is not often an interest rate or maths problem - it's more often behavioural. Go to the source of the problem to change the outcomes. Is the person who looks you in the mirror the problem? Deal with reason behind the debt and then use the 7 Step System below.

One more thing before the 7 Step System….

To compound the benefits of debt reduction it is important to understand the key difference between an asset and a liability. As the diagram below illustrates, the more debt or liabilities you have, the higher your expenses will be. The more true assets you have, being those that pay you an income, the more income they will produce for you. This is also the best kind of income as it is passive and generally very tax effective.



Using these principles ask yourself if your home and car are assets or liabilities.

The 7 Step System Debt Busting System

When trying to get out of debt, many people look at trying to pay off the highest interest rate loan first – typically being the credit card, or a department store hire purchase card. Of course, if the card is not destroyed or new disciplines put in place then the amount owing can become a moving target.

Unfortunately, human nature as it is, we often get bored or distracted with this method and end up giving up.

At God's Money Matters we have discovered a powerful yet simple system that works by keeping people on track. In fact it has proven to be a method that can actually help pay off debt significantly faster than ever before, without having to come up with any additional money. It also doesn't focus so much on complicating matters trying to figure out what interest rate is highest on each loan. It works because it is simple and easy, as well as providing satisfaction when each goal is achieved. When the system is followed the result is to also end up with an investment portfolio all in the same time it would have taken just to clear the original debts.

In summary, the steps are...

Step 1. List all current liabilities and repayments

Step 2. Order these based on the 'Repayment Ratio'

Step 3. Pay off the loan with the lowest Repayment Ratio first. We all like to achieve goals and celebrate wins, which helps keep the discipline of sticking with the plan as we can actually see that we are getting somewhere

Step 4. Set timeframes in which the debt is expected to be cleared, and note these in your diary

Step 5. Once each loan is paid off, use the extra cash flow from the repayments freed up from the previous loan to put against the next loan on the list, being the loan with the next lowest repayment ratio

Step 6. Continue until all loans are cleared

Step 7. Once all loans are cleared, invest the funds that were being used for loan repayments to build wealth and passive income

Here's How The 7 Step System Works In More Detail...

1. List all current liabilities and repayments

Lists all current liabilities by name, the amount owing, the current repayment amount (convert all to monthly if paid weekly or fortnightly). Then divide the loan amount by the amount of the repayment giving a 'repayment ratio'.

Example:

Debt Name	Amount Owing	Current Repayment per month	Repayment Ratio
Credit Card	$2,700	$1,000	3
Home Loan	$82,000	$823	100
Personal Loan	$30,000	$368	82
Car Loan	$27,000	$650	42
Total	**$141,700**	**$2,841**	

2. Order these based on the 'Repayment Ratio'

Once the Ratio is calculated, put them in the order of the lowest ratio first.

Example:

Debt Name	Amount Owing	Current Repayment per month	Repayment Ratio
Credit Card	$2,700	$1,000	3
Car Loan	$27,000	$650	42
Personal Loan	$30,000	$368	82
Home Loan	$82,000	$823	100

3. Pay off the Loan with the Lowest Repayment Ratio first

Using the example above, focus on paying off the credit card first. This will take a short time, so there is plenty of motivation to keep going as 'the wins' are celebrated and a feeling of success builds motivation. If there is extra cash flow available, then this should be directed towards the lowest ratio loan.

4. Set timeframes in which the debt is expected to be cleared, and note these in your diary

Using a loan calculator (there are many available online) to calculate the estimated repayment end dates and then set these in your diary. You might also wish to put a table on your fridge or somewhere prominent to keep you focussed and on track.

Example:

Debt Name	Amount Owing	Current Repayment per month	Target Date for Debt Clearance	Done ✓
Credit Card	$2,700	$1,000	22-June-2009	
Car Loan	$27,000	$650	28-Oct-2010	
Personal Loan	$30,000	$368	24-Sep-2011	
Home Loan	$82,000	$823	18-Feb-2012	

5. Once each loan is paid off, use the extra cash flow from the repayments from the previous loan to put against the next loan with the next lowest repayment ratio loan

Cascade each loan payment down to the next debt on the list which creates the snowball effect and will have you paying off these debts much faster than the target dates above. This is simply employing cash flow that was being used beforehand so is not changing your cash flow position at all.

6. Continue until all loans are cleared

Simply follow steps 1 to 4 until all loans are cleared. In the example used above, assuming only the current loan repayments are used then debts would be cleared in just under 12 years. If the Debt Freedom Plan is implemented then all debts would be cleared in under 3 years*, saving a massive $312,000 in loan repayments and lots of interest.

7. ***Once all loans are cleared, invest the funds that were being used for loan repayments.***

If, once all the loans are repaid, the total loan repayments of $2,841 per month are put to work and invested over the next 9 years – being the original loan term, (i.e. another 9 years after all the debts were paid off) in a balanced investment portfolio returning a net 5.25% then it results in an investment portfolio of approximately $396,599#.

This is a massive turnaround from status quo, all without adjusting current loan repayments or dipping into the current budget.

To obtain more information or help with setting up your personal Debt Freedom Plan, please contact God's Money Matters at www.godsmoneymatters.com

* Assumes Credit Card interest at 18%, Car Loan interest at 8.5%, Personal Loan interest at 9% and home loan interest at 6.5%
# Assumes a net return of 5.25% including income and capital growth and reinvestment of investment income for an investor with a 30% marginal tax rate investing in a managed investment fund. The rates of return do not reflect any specific choice of investment option or investment manager, nor do they reflect the investment returns that the investment managers have achieved in the past or may achieve in the future. The illustration shows how the product might work by showing the effect of fees and investment earnings. It assumes that the investment is across a range of options generating an overall net return of 5.25%pa.

If any fees change, the projected account balance will also change.

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