



Know definition of good, bad debt

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It sounds counterintuitive, but there is such a thing as good debt.

A way to recognize if an expense constitutes good debt is to ask if it creates value. For example, taking on debt to finance a college education creates value in the form of increased earnings for years to come; taking out a mortgage creates value in the form of home equity; and obtaining a loan to fund a business venture creates value in the form of a new stream of revenue.

On the other hand, a classic example of bad debt involves using a high interest rate credit card to purchase a durable good (like a new television) that loses value the moment you purchase it. The television is worth less the longer you have it, yet you still continue to keep paying off both the actual cost of the television and the interest heaped on what amounts to a super pricey loan from a credit card.

The lesson: avoid taking on bad debt, and when looking to finance good debt like a college education, steer clear of credit cards that more often than not charge sky-high interest rates to let you borrow needed funds. Also keep in mind that credit cards do not offer a set term for paying off a balance, which means you could easily end up paying twice as much (or more!) of something's true cost if you make only minimum monthly payments. This can lead to your accumulating an excessive amount of bad debt that can result in missed or late payments. And that in turn will drag your credit rating down, which will make it harder for you to obtain a low-rate loan in the future.

Better options for funding good debt expenses are installment loans, mortgages, car loans and student loans. They can be obtained through a credit union and bank and almost always offer lower interest rates than



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A mortgage is a type of good debt because home equity creates value.

KEY POINTS

- Good debt (such as a college, home or business loan) creates value. Bad debt, which often results from abusing credit cards, results from buying too many things that lose value over time.
- To fund good debt, opt for a loan from a credit union or bank.
- Heed the 20-10 rule which states that you borrow no more than 20 percent of your yearly net income (the money you take home after taxes) and that no more than 10 percent of your monthly net income goes toward debt repayment (this percentage does not include a mortgage payment).
- Installment loans state upfront exactly how much the loan will cost and what the repayment period will be. Opt for the shortest term possible to reduce the amount of money you will shell out in interest payments over time.
- The most common mortgages are fixed-rate mortgages (FRMs) and adjustable rate mortgages (ARMs). FRMs have the same monthly payment for the length of the loan while ARM interest rates change based on rises and falls in a particular index.
- Avoid credit cards to fund good debt and shop around for loans like you would for a credit card. Compare rates and fees, read the fine print and ask the lender to explain anything you don't understand.

credit cards and set a timeline for repayment.

Even still, take care not to accumulate too much good debt by heeding the 20-10 rule which states that you borrow no more than 20 percent of your yearly net income (the money you take home after taxes) and that no more than 10 percent of your monthly net income goes toward debt repayment (this percentage does not

include a mortgage payment).

We will take a closer look at college and car loans later on; for now, let's examine how installment loans and mortgages can help fund good debt.

Installment loans

Installment loans state upfront exactly how much the loan will cost and what the repay-

ment period will be. They are typically offered by auto dealers to finance cars or by banks and credit unions to finance other miscellaneous purchases. Terms usually range between two and six years.

Opt for the shortest term possible — the longer the term, the more you will shell out in interest payments. Also look for a loan with no prepayment penalties. You may then work to pay off the loan before the stated term to save on interest payments.

Mortgages

The most common mortgages are fixed-rate mortgages (FRMs) and adjustable rate mortgages (ARMs). FRMs have the same monthly payment for the length of the loan, which is usually 15 or 30 years.

ARM interest rates change based on rises and falls in a particular index. The monthly payment also changes, making an ARM riskier than an FRM. ARMs often lure home buyers with low monthly payments, which can later increase by a large percentage.

A subprime loan has an even higher potential to land you in financial distress. These more expensive loans — responsible for much of today's economic woes — are marketed to buyers with impaired or limited credit histories. Many subprime borrowers defaulted on their mortgage payments, leading to mass home foreclosures. Many others owe more on a house than it's worth or are stuck in houses they cannot afford, sell or refinance.

So in addition to avoiding credit cards to fund good debt, shop around for loans like you would for a credit card. Compare rates and fees, read the fine print and ask the lender to explain anything you don't understand.

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10 questions to ask before you sign the dotted line

When you decide to use credit, the amounts you borrow add up to become your debt. Debt is the entire amount of money you owe to lenders. We discussed the upside of debt earlier — you can enjoy an item or a service now. The downside of debt is that it puts a claim on your future income, and if you take on too much debt, it can derail your financial plan — and your future.

To help stay out of debt, ask yourself these questions before you sign a credit card's dotted line:

1. Do I really need this item right now or can I wait?

2. Can I qualify for credit?
3. What is the interest rate (APR)?
4. Are there additional fees?
5. How much is the monthly payment and when is it due?
6. Can I afford to pay the monthly payments?
7. What will happen if I don't make the payments on time?
8. What will be the extra cost of using credit?
9. What will I have to give up to pay for it? (Opportunity costs.)
10. All things considered, is using credit worth it?

Source: *National Endowment for Financial Education Financial Program Study Guide*

CAREER CORNER



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Name: Adam Suroviec

Occupation: I work in the information technology support department at the Erie Veterans Affairs Medical Center.

Typical day: I usually address five to 10 help desk tickets each day. Common requests include obtaining a forgotten user name or password and setting up e-mail encryption, which secures e-mail so that no personal information is leaked.

I also work on bigger projects; right now, I am building a platform for Web-based interface that will allow patients do things like renew their prescriptions and interact with their doctors online.

Favorite part of job: I love helping those who help veterans, a group of people I greatly admire. It's always been my dream job to work here.

Education: I received a two-year degree in network administration, as well as a hardware technician certificate, from Erie Business Center.

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It is in the economy's best interest that consumers take on good debt like mortgages or business loans. Yet with banks and credit unions lending less money, many people are unable to borrow money. During times like this, the government will oftentimes take steps to stimulate lending. Look through today's newspaper for articles on this topic. Do you think the government is taking appropriate steps to help people obtain loans that would fund good debt? Many

students worry about affording college. Do you think enough is being done to help students obtain fair loans? If not, what do you think the government should do to help make college loans easier and more affordable for students?



Check out these Web sites to learn more:

www.teachmeaboutmoney.org
www.eriefcu.org/savings/financial-literacy

www.unitedwayerie.org/financial-stability
www.goerie.com/nie

www.erie.ja.org
www.eriebc.edu