Education Resource Center

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Debt, the Worst Four-Letter Word

When I was a kid, four-letter words always got me in trouble. In fact, my brother tells me that when I came home from my first day of school, a classic four-letter word got my mouth washed out with soap! As you can see from that episode, I have never had any love in my heart for four-letter words. That is, until recently. One thing changed my entire outlook on life and four-letter words. What is that one thing, you ask? Taxes (which, by the way, is a five-letter word). Yes, taxes and good financial management changed me and my outlook on—you guessed it—four-letter words.

Because this is a family publication, I would suggest you ask your children under the age of 18 to leave the room. I am about to use a four-letter word and do not want to offend any youngsters. Have they left? Good. If you are offended by four-letter words, please stop reading this right now. Burn this page and dispose of the ashes properly. Are we ready? Here goes:

Debt. Debt, debt, debt. There. I said it and I'm glad. I have a feeling that some of you would like to wash my mouth out with soap, but first hear me out. This poor word, debt, has gotten a bad rap for many years because it is totally misunderstood. Yes, the majority of people and some so-called "financial gurus" will tell you that debt is a four-letter word and they are both right and, at the same time, very wrong. What they are right about is obvious. What they are wrong about is just what debt is and how some debts can in fact benefit you. Are you still with me?

Let's examine debt a little closer. Debt is at least one four-letter word that is in the dictionary! I am not professing that you should run out and just go crazy with your credit cards and max out every card you have, because you think I have said that debt is good. That debt is bad and that is where debt lives up to its title as being a four-letter word—and one of the worst. That is what I refer to as "bad debt."

Good debt (and there is such a thing) is debt that works for you. Debt that works for you? How so? Well, what about a mortgage? It allows you to own the home that if you had to pay cash, you couldn't afford. It also allows you to "buy" money at the cheapest price you will ever get money for. What else allows you to enjoy an item now even though you don't finish paying for it for up to 30 years? Yes, you do pay interest to use "their" money, but it's low-cost interest; and best of all, it's still tax deductible.

If you purchase a house and your interest rate is 7%, after taxes that rate is lowered to just 4.2%. Now that's cheap money! Why pay that off when most homes are not even appreciating at that rate? It just doesn't make good sense. The same is true with using a 15-year mortgage instead of a 30-year mortgage. Let's look at the numbers. We will use a $100,000 mortgage. For 30 years the rate is 8.13% with a payment of $742.00 per month. The 15-year rate is 7.75%, with a payment of $940.00. On the surface the 15-year will save you $98,000 in interest payments. Since the interest is deductible the savings are only $67,000, but that is still a sizable saving. Let's not forget inflation, and with a 4.5% rate, the savings are cut to $9,000. Still a savings. The difference is the payment is $199.00 per month—and over 15 years, that is $35,820, before we add in any interest on that $199.00 per month. Still not convinced that good debt is good?

So you pay off your house and are "debt free," and now you need some money. You decide to get a mortgage so you can get your hands on your money. Guess what? Now that interest on your mortgage is not deductible. Okay, so you decide to use your equity to help with your retirement, and you go to your friendly banker and ask for a home equity loan. You have value and they ask you one simple question: How will you pay the loan off? You have no income except for this money? NO LOAN. If they give you a loan, who knows what interest rates will be then. In other words, you have to pay to get to all that money you stashed in your house for "safe keeping."

Good debt or bad debt? Smart move or dumb move? You tell me. Remember this one rule of finance: Money is worth what you can borrow it for. If it cost you more than what you can earn on it, then it's bad debt. If you can earn more than what it is costing you to use it, then that is good debt. Earlier I showed you that a 7% mortgage only cost you 4.2%. Why pay off 4.2% money when you can earn so much more with that money and still have the house to live in?

Options. I like options. With a 30-year mortgage, I can always put in extra cash and pay it off sooner if I find out later that Greenfield did not know what he was talking about. If I am in a shorter mortgage, the only options I have are to re-finance—which costs me money—or default. Not good options. If I am "debt free" my only option is to get a new mortgage (not good) or get an equity loan at whatever the rates are at the time. Good options? You tell me.

Debt, debt, debt. I didn't warn you that time because I hope that your view of debt has changed. Debt should not be treated like the other four-letter words we see written on bathroom stalls and the overpasses on the expressways. If understood and used properly, debt can be good and help improve your financial outlook on life!

About the Author

Stanley B. Greenfield, RHU, has been engaged in the fields of Financial Management and Insurance for almost 40 years. Mr. Greenfield is a Registered Financial Consultant, and was awarded the designation of RHU, Registered Professional Disability and Health Insurance Underwriter, in 1979, as one of its Charter Members.

Mr. Greenfield has a client base that is international in scope. He has authored hundreds of articles concerning tax and financial management and practice management, and has spoken throughout the world on these subjects to both business and professional associations. Mr. Greenfield is a regular contributor to numerous professional journals as well as financial planning journals. Currently, Mr. Greenfield lectures regularly at several of the Chiropractic colleges, and serves as an adjunct professor for the business classes. Mr. Greenfield has authored Chiropractor's Financial Survival Kit, Volume I, which is being used as the textbook for the business class. Volume II of this series has just been published and was written as a guide for the practicing Chiropractor. Both volumes are available at several of the Chiropractic colleges, or can be ordered directly from the author. Mr. Greenfield also serves as a training consultant for the World Learning Organization, which brings in professionals from around the world to train with experts in this country.