UPDATED AND REVISED EDITION

DEAL with YOUR DEBT

FREE YOURSELF FROM WHAT YOU OWE

LIZ WESTON

Author of the National Bestseller, *Your Credit Score*

Praise for the First Edition of *Deal with Your Debt*

"*Deal with Your Debt* is an objective, practical, and insightful book on a vitally important topic to many Americans. I recommend it highly and without reservation."

—**Eric Tyson**, syndicated columnist and author of *Personal Finance for Dummies* and *Let's Get Real About Money!*

"The author has managed to cut through the noise and find a helpful and friendly way to advise consumers on the best way to manage their debt. If you're looking for a way to lower your debt, this book will prove indispensable."

—**Ilyce Glink**, radio talk-show host, financial reporter, and author of *50 Simple Steps You Can Take to Improve Your Personal Finances*

"Liz Weston's no-nonsense advice for conquering debt is right on target. It's one of the most comprehensive and straightforward guides available. If you want to get ahead, let Liz show you how."

—**Gerri Detweiler**, consumer advocate and founder of UltimateCredit.com

"Debt-stressed? No need to be. In her characteristic no-nonsense style, Liz Weston explains smart ways to pay off the debts that hurt you and get the best rates and terms on loans that can help you. It's an easy read—and provides news you can use to fix your finances."

—**Kathy Kristof**, syndicated columnist, *Los Angeles Times*

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Updated and Revised

Liz Weston

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About the Author

Liz Weston, an award-winning personal finance columnist, is one of the Internet's most-read money experts. *The New York Times* called her *The 10 Commandments of Money* a "wonderful basic personal finance book…[with] enough counterintuitive ideas to keep even people who know a bit about personal finance reading further." Her best-seller *Your Credit Score* is now in its Fourth Edition. Her columns run twice weekly on MSN Money, and her Money Talk Q&A appears in print nationwide, from the *LA Times* to *Stars and Stripes*. She has appeared on *Dr. Phil*, *NBC Nightly News*, the *Today Show* and *CNBC Power Lunch* and is a regular contributor to *Marketplace Money*. Her books also include *There Are No Dumb Questions About Money*.

Introduction

If you're picking up this book, you're probably concerned about your debts.

If so, you're in good company. Half of the people surveyed in a recent Harris poll said they were living paycheck to paycheck, which makes it hard to pay down debt or save for the future. One out of four people in a 2011 survey said they were worried about paying the minimums on their credit cards. The Federal Reserve reports that one out of seven families has debt payments that eat up 40% or more of their incomes—a level of debt the feds say is an indicator of "financial distress."

Some people have good reason to worry. They've maxed out their credit cards, or struggle with an unaffordable mortgage, or face repossession of their car. They may have student loans they can't afford or payday loans that chew through every paycheck. Many have stopped being able to juggle all they owe: One in 10 American families in 2010 was 60 days overdue on at least one bill.

If you're one of those folks, you'll find plenty of information in this book to get you back on your feet.

But you don't need to have overdosed on plastic to be concerned about your debt situation. Most people get little if any education about the right ways to acquire and manage borrowed money. They rely on lenders, family, and friends to tell them which loans are "good" or "bad" and to advise them how much they can afford. Many veer between extremes, thinking debt is evil one minute and the next applying for yet another new department store card to get that 10% discount.

The typical book on debt, meanwhile, focuses almost entirely on how to pay it off and ignores when debt might actually be beneficial to your overall financial life.

In reality, debt can be an enormously helpful financial tool, allowing us to buy homes, get educations, and build businesses. Instead of sucking us dry, it can help give us the cash flow we need to grow our long-term wealth. But we need to know how to get it, when to get it, how much to get, and when it's time to pay it off.

This book is designed to help you identify which debts are toxic to your financial health and which actually help you get ahead. You'll learn the smart ways to deal with your debt, including which loans you should pay off and which you should keep. You'll discover how to manage your finances and your credit so that you'll be able to borrow all the money you need at the best rates and terms. In short, you'll be able to craft a sensible, workable plan to achieve your goals and truly deal with your debt.

So let's get started!

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Isn't Debt-Free the Way to Be?

Debt isn't the root of all evil—but sometimes it sure feels that way.

If you're struggling to cover your bills and are being hassled by collectors, you may curse the day you applied for your first credit card. If you're straining to make minimum payments that feel like maximums, you may swear you'll never borrow again. If you've just graduated with massive student loans, you may question why you ever thought going into debt for education was a good idea.

Even if you've got your bills under control, you may fret about the interest you're paying to some faceless lender or worry that some setback—a job loss, illness, or divorce—could sink your financial ship.

Many books about debt agree with you that owing money is awful, terrible, wicked, and something to eradicate as soon as you can. The authors recount how many dollars are wasted each year on interest payments, and they use anecdotes of people who lost their homes, their marriages, their health, and their peace of mind to too much debt.

They're right that, when mishandled, debt can be as corrosive as cancer. But the usual prescription is to pay off everything as quickly as possible and learn to live debt-free. The message is enforced with testimonials from people who overcame mounds of bills and who are proud that they live entirely on cash, no longer owing anyone a dime.

Unfortunately, this approach may not be realistic, and it can easily backfire.

Debt Isn't the Enemy

People with serious debt problems may try to do too much too fast and then give up in despair. Or they might pay off the wrong kinds of debt, stranding themselves with too little flexibility to survive a financial crisis. In their zeal to pay off debt, some people neglect other important goals, such as saving for retirement, a home, or college, and ultimately end up hundreds of thousands of dollars poorer than they might have been.

Worse yet, they might be encouraged to continue fighting a battle they simply can't win.

If you're having debt problems, you need information, advice, and a clear-eyed assessment of your financial situation so that you can make the best choices for yourself and your family. Short-term fixes and inspirational slogans might help, but you shouldn't choose them at the expense of your long-term economic health.

Even if you're not in a crisis, it will help you enormously to view debt for what it is: a financial tool that's virtually essential for building wealth, reaching your goals, and living happily.

Think about it. Few of us could afford a home without taking on a mortgage, and many couldn't swing college educations without the help of a few loans. Consider the payoffs:

- Even after the housing bust, most American households own their homes—and benefit from that homeownership. The median net worth for homeowners in a recent Federal Reserve study was $174,500, compared with just $5,100 for renters.

- Student loans helped more than 50 million people attend college, an investment in their futures that pays off in higher incomes and greater productivity. One study found that college graduates usually recouped the cost of their education, including the earnings they missed while attending school, by the time they were in their early thirties.

Debt also can help you survive a job loss, buy a safe car for your growing family, or even start a business—and sometimes all three.

I was raised by a mother who hated debt. She taught me to pay off my credit cards in full every month (thank you, Mom!) and to live within my means. I inherited her distrust of lenders to the point that, after my sophomore year at a small Northwest college, I turned down Stanford University's offer of admission as a transfer student because its financial aid package consisted entirely of loans rather than scholarships or grants.

Imagine my surprise, then, the first time I heard a financial planner tell a client that debt wasn't necessarily bad.

The advice was part of a "money makeover" feature I was writing for my newspaper. The planner suggested our makeover subject invest in her retirement plan rather than rushing to pay off her low-rate student loan debt. The idea that debt repayment needn't always be a top priority was news to me.

Later, I would consult with planners who routinely urged their clients to open home equity lines of credit to supplement their emergency funds. I had always thought that home equity was sacrosanct, but these planners—smart, objective folks at the top of their field—pointed out it could also be a tool.

I'm glad I got that education because a few years later my husband and I were able to put it to use.

My husband, who worked in the animation industry, was laid off during a massive corporate downsizing that put 4,000 artists out of work. It was several months before he found another full-time job.

Just when our emergency fund was hitting a low ebb, Microsoft approached me about leaving my job at the *Los Angeles Times* to write for MSN. The money was great, and I could work from home—but because I would be forming my own corporation and MSN would be a client, there would be a three-month gap before I got my first check.

Oh, yes, and right after I decided to take the leap, I discovered I was pregnant.

Now, many in the anti-debt crowd would have told me not to leave my job—that it was too great a risk. I took it, though, and we lived off credit cards until those first checks started coming in. After our daughter was born, we used our home equity line to purchase a safer car.

Shortly afterward, our income soared. The credit cards and home equity borrowing have long since been paid off. Debt gave us the flexibility to seize an opportunity that might otherwise have passed us by.

When "Good Debt" Isn't

Debt clearly has a place in our economy and in our lives. That's what many financial gurus are trying to get across when they divide debt into "good" and "bad" categories. Typically, mortgages, student loans, and borrowing to start a business are considered good; most other borrowing is considered bad.

But that leads to another problem with typical debt advice because too much "good" debt can sink you just as deep as too much "bad" debt.

That became obvious during the mortgage mess. Lenders loosened their standards to a shocking extent, offering massive loans to people with modest incomes—sometimes without requiring any proof of those incomes. Lenders made money selling the mortgages to investors, who wanted ever-higher returns. That led to lenders pushing ever-riskier loans, until the whole card game collapsed.

As a result, millions of people have lost their homes, and millions more are underwater, owing more on their suddenly devalued homes than those properties are worth.

Some warn that a similar bubble is building with student loan debt, which totals $1 trillion as of this writing—more than what's owed on credit cards.

I've received countless e-mails from people who borrowed $20,000, $50,000, and even more to attend college, only to find that they can't get a job in their field or make even the minimum payments on what they owe. One poor soul borrowed every penny it took to attend an expensive private college; her bachelor's degree left her nearly a quarter of a million dollars in debt. Many who signed up for student loans, particularly private student loans, had no clear idea of how much their borrowing would cost them when they graduated; they just knew that lenders were eager to give them the cash and that their educations were supposed to help them get ahead.

Furthermore, student loans are almost never wiped out in bankruptcy court, so they can be an albatross that hangs around your neck for life.

Charles borrowed more than $100,000 for his education, but a divorce caused him to drop out of his doctoral program before he got his PhD. He found a job paying $40,000 a year, and his lender agreed to reduce payments based on his income. But his debt is still accruing interest.

"My loan just keeps getting bigger and bigger," he wrote. "I have no hope of paying [it off] unless I win the lottery."

These horror stories make it clear that you can't depend on a lender to tell you what you can or can't afford. You need to set your own limits, and they must be limits you can live with.

Which Debts Should You Tackle First?

Then there's the issue of how to prioritize your bills. Often borrowers are advised to figure out which of their debts have interest that's tax deductible, and to pay those last. They're told to concentrate on paying off the highest-interest-rate, nondeductible debts they have, while paying the minimum on other debts. Once the high-rate debt is paid off, they're told to apply the same payments to the next-highest-rate debt, and so on.

In some cases, though, it can make more sense to pay a lower-rate debt first, or even a deductible debt before a nondeductible one.

Ginny owed $30,000 in student loans at 5% interest as well as $35,000 on her home equity line of credit, which hovered around 4%. Her income was too high to deduct her student loan interest, but her credit line payment was a write-off. The conventional wisdom would have her pay the student debt first.

But federal student loans have a feature not common to most other debt: You can get a forbearance (a temporary suspension of payments) that allows you to skip payments while you're unemployed. Because Ginny works in an unstable industry, she resolved to pay down the home equity line first so that she could use the freed-up amount of credit again in an emergency.

The key to managing your debt wisely is knowing which debts are helpful to you and which will leave you worse off. You need to figure out how much debt you can realistically take on so that you don't swamp your financial ship. You need to know when to accelerate your payments and when to pay the minimum. In short, you need to look at debt as a key part of your financial plan, rather than as a scourge that can and should be erased from your life.

Ultimately, being debt-free is a great way to be. But you want to get there the smart way.

Why Debt Management Sounds Strange

Long before Ben Franklin opined, "So rather go to Bed supperless than rise in Debt," Americans believed there is something shameful about owing money.

In colonial times, excessive debt was a crime that could land you in jail—where you would remain until you, or your family, somehow paid what you owed. More than a few people died of the rampant disease and terrible conditions that typified prisons of that era.

Debtors' prisons weren't outlawed in the United States until 1841, and bankruptcy continued to carry a huge stigma until the end of the twentieth century.

Of course, our cultural suspicion of debt hasn't kept us from piling up mounds of it. If you know anything about debt in America, you probably know that we owe more than people in any other country, and our pile of IOUs just keeps growing:

- The amount we owe on credit cards and other revolving lines of credit dropped sharply from its 2008 peak of $972 billion, as chastened consumers and lenders cut back. But the $803 billion we owed in mid-2012 is still more than twice as much as we owed in 1990, adjusting for inflation.

- The amount and length of the typical car loan continues to increase. In the 1980s, the typical car loan lasted three or four years; today, the majority of all new car loans last more than four years. Some last eight or even nine years.

- At the peak of the housing bubble, the average homeowner's equity represented just 55% of the home's value—down significantly from the 65–67% levels that were typical in the decades before 1990. What's remarkable is that equity dropped even as home prices rose spectacularly, indicating that people were putting down less and draining the value from their homes through home equity lending at a furious pace.

It's obvious that some people overdose on all this debt. About a million households file for bankruptcy protection each year. Foreclosures are still rampant, reflecting not just excessive borrowing but increased unemployment from the economic tailspin.

Even when people manage to make their payments, the price of debt can really add up over time. The typical homeowner will pay for her house two or three times over by the time she retires a 30-year mortgage. Carrying just $5,000 on your credit cards can cost you $750 a year on average—money that, if invested instead, could grow to $200,000 over your working life. Most people who buy new cars these days are "underwater" as soon as they drive off the lot. They will make payments for years before their car debt is less than what the car is worth.

When Debt Repayment Plans Go Awry

So how could anyone argue that paying off debt is a bad idea?

I can, if you're approaching it in any of the following ways:

You're paying off the wrong debt. In the late 1990s, banks started pushing biweekly mortgage payment plans aimed at helping homeowners pay off their houses faster. By making payments once every two weeks, instead of every month, the homeowner would effectively make one extra house payment a year, shaving years—and thousands of dollars in interest costs—off their loans.

As interest rates fell, the savings became somewhat less impressive, but you could still save money. For a $200,000 loan at 4%, making just one extra payment a year would shave four years off a 30-year mortgage and save over $21,000 in interest.

Volatile stock markets made these plans even more popular. People felt a lot better about "investing" money in their steadily appreciating homes than they did "throwing it away" on stocks.

The problem with this approach is that many who pursued it were neglecting other financial goals or carrying other, far more expensive debt—including credit cards and personal loans.

The average credit card carries an interest rate of about 16%, much higher than the mortgage in our example. Furthermore, you typically can't deduct credit card interest on your tax returns. The deductibility of mortgage interest can reduce the effective rate you pay to 3% or even less, depending on your tax bracket.

There's something else you should consider—inflation. Most people realize that higher prices gradually erode the value of the dollar, which means many things will cost more in the future than they do today. But inflation also makes debt *cheaper* as time passes. The fixed-rate mortgage payment that seems so onerous today will be much less so in 10 years and might seem almost an afterthought in 30 years.

"Most people don't understand that even modest inflation makes a fixed mortgage payment cheaper every year it's in existence," wrote David, one of my readers on MSN. "My first mortgage, 28 years ago, was $271.60 a month. Had I stayed in that house, I would be spending far more today on my monthly utility bills than my mortgage."

By contrast, money you invest has a chance of beating inflation over time. That means your purchasing power can actually grow, particularly if you invest it in stocks or stock mutual funds. If you're forgoing the chance to invest while you prepay your mortgage, you've really got your priorities backward.

Mortgages are some of the cheapest money you'll ever borrow. Such low-rate, tax-advantaged debt is usually the last kind of borrowing you want to pay off.

You're limiting your financial flexibility. Carlos graduated from college in 1998 with $20,000 in student loans—more than most students at the time, but about average these days. He consolidated his loans to lock in the prevailing 7.455% interest rate. He decided to double his $237 monthly payment to retire his loan faster. Instead of taking 10 years to pay off the balance, he did it in just over five, saving about $5,000 in interest.

Then he lost his job.

If Carlos had put the extra payments into savings instead, he would have had an emergency fund of more than $11,000 by the time he was let go. He could have lived off the cash and asked his student lender for a forbearance while he looked for work. Instead, he had no cash, and his landlord, utilities, and car lender weren't interested in giving him a forbearance; they all wanted their regular payments on time.

By paying off his debt early, he limited his financial options instead of enhancing them.

This issue of financial flexibility has become critical in the last decades as incomes have become more variable, layoffs more common, and bankruptcies epidemic.

About half of households live paycheck to paycheck, and fewer than one in three has enough cash saved to survive more than three months of unemployment. At the peak of the recession, the median duration of unemployment was over 20 weeks—more than five months. Six million people had been out of work for 27 weeks or more.

So many families are living so close to the edge that any crisis can tip them over the brink: a job loss, divorce, illness, or accident. (The Census Bureau estimates that 49 million Americans are uninsured, while millions more are underinsured.)

Instead of focusing single-mindedly on paying off all debt, today's families need to figure out how to put themselves on sound financial footing overall.

You're cutting yourself off from credit entirely. I often receive e-mails from folks who are paying off their credit cards and proudly closing down the accounts once the balances hit zero. They vow to never again use another piece of plastic.

Yet credit cards can be an important safety valve to help families survive job loss or other setbacks. If you don't have enough cash set aside in an emergency fund, you can live off your cards temporarily until the crisis passes.

Furthermore, you generally need to *use* credit to *get* credit. The credit-scoring systems employed by most lenders require you to have and use revolving accounts like credit cards to get the best scores. You don't have to carry debt to have good scores—that's a myth—but you do have to have, and use, credit accounts.

Closing accounts can actually hurt your scores, potentially making it more difficult to get future credit. The next time you need a mortgage or a car loan, you could be denied or pay higher interest than if you'd kept your credit scores in good shape. Also, most insurance companies use credit information to determine your premiums. Poor scores or thin credit files could cause you to pay more for coverage.

None of this means that you shouldn't learn to live on cash alone while you're repaying your debt. Just don't close the accounts once you've paid them off unless you really and truly can't keep from using them otherwise.

There are certainly people who have completely lost the ability to control their spending. One of them e-mailed me after filing bankruptcy for the third time. He wasn't the victim of bad luck, bad health, or unemployment; he simply spent too much money.

"If I make $150,000, I spend every single dime," he wrote. "What can I do to get my credit back and stop this madness?"

Credit to this man is like booze to an alcoholic. There is no safe way for an alcoholic to have even a single drink, and there may be no safe way for a chronic credit abuser to have plastic.

If that describes you, consider getting help through therapy or a 12-step program like Debtors Anonymous or Overspenders Anonymous.

Most people, however, can survive a credit crisis and move on to responsible credit use.

You're neglecting your retirement savings. One of the pieces of debt advice that most disturbs me is when people are urged to forgo retirement contributions to free up cash to pay their credit cards.

Yes, this will get the cards paid off more quickly—but at what long-term cost?

The problem is that contributions to retirement plans are usually a use-it-or-lose-it proposition. In other words, you can't get back an opportunity to contribute to a tax-advantaged retirement plan once you've let it slip away.

Many employers, for example, will put 50 cents into your 401(k) for every dollar you contribute, up to a certain cap—typically 6% of your salary. If you make $45,000 but don't contribute that 6%, you're missing out on $1,350 of free employer matching money each year. Even worse, you're passing up all the future, tax-deferred growth of your contribution and the employer match.

Let's say you suspend contributions to your 401(k) for five years while you pay off debt. We'll assume that you resume contributions at that time and retire 30 years down the road. If your account earns an average 8% annual return—which, given long-term historical trends, is a reasonable assumption for a portfolio invested 70% in stocks and 30% in bonds—your five-year hiatus could cost you more than $200,000.

You can try to make up for lost opportunities once your debt is paid off by making bigger payments to your retirement plans. But the amount you can contribute to tax-deferred plans is limited by law and may be limited further by company policy. Even if you could somehow compensate for the contributions you failed to make, you simply can't get back the free money you passed up in company matches, or the value of time in helping your money grow.

Here's another example of how this trade-off works. One of the posters on a message board I monitor at MSN was trying to decide what to do with an extra $250 a month: pay off her car loan or fund a Roth IRA.

Accelerating the payments on her $20,000 car loan would save two years on the five-year loan and save her more than $1,000 in interest, and it's the option many posters on the board urged her to take.

I pointed out that the same money, contributed to a Roth, could grow to more than *$175,000* of tax-free money in 30 years.

This isn't just an academic issue. Saving for retirement is critical, and by all reports most Americans are doing a pretty lousy job. Few of us will have the cushy, traditional pensions that previous generations relied on to fund their retirements, and some worry that Social Security won't be much help either. We need to be saving more and starting earlier—not delaying or interrupting our contributions.

You're raiding your retirement funds. Chris and Suzanne in Tennessee have $40,000 in credit card debt and $18,400 in an old retirement plan at Suzanne's previous employer. They want to pull it out to pay off part of their debt. They e-mailed me, asking if this was the right thing to do.

"We have been in debt for many years, and this could help kick-start us in getting out of debt," they wrote.

Most people have at least a vague notion that carrying credit card debt is a bad idea. So when they leave a job and their employer sends them a check for their 401(k) balance, they think they're being responsible by using the money to pay off credit card balances.

But if there's one thing worse than suspending retirement savings, it's raiding what you've already set aside.

Chris and Suzanne would face a tax bill come April 15 for taxes and penalties that will equal one quarter to one half of the withdrawal they just received. Furthermore, they're giving up all the future tax-deferred returns that money could have earned. (Figure that every $1,000 you withdraw will cost you $10,000 or more in future retirement income.) What they should do is roll the money into an IRA and find other cash to pay off those credit card bills.

Otherwise, they're just opting for another quick fix that simply makes their financial situation worse. That kind of approach—grabbing for a short-term Band-Aid rather than the long-term cure—prevents many people from overcoming their debt problems.

Remember how I said there were worse ways to spend retirement money? I often get e-mails from people asking how they can withdraw money from their retirement funds so that they can pay off their mortgage early.

Think about that. They're proposing giving up tens of thousands of dollars in tax-deferred future gains and incurring a fat tax bill, so that they can pay off a low-rate, tax-deductible debt. That's just nuts.

Some people propose a variation on the theme. They understand that withdrawals from retirement accounts are stupid, but they think it's a good idea to borrow from themselves via a loan from their 401(k) rather than continue paying interest to a lender.

The big problem with this approach is that 401(k) loans typically come due if you lose your job. If you can't pay back the money quickly, it can be taxed and penalized as a distribution.

There's something else to consider. If your financial situation really takes a dive, you may be able to wipe out your credit card debts in bankruptcy. Once you've paid them off with a 401(k) loan, that option is gone.

I also wonder how many folks who use 401(k) loans to pay debts are really covering up a serious spending problem. As long as they can keep shuffling loans around, they may never address the real cause of their financial problems. Forcing yourself to leave retirement plans for one purpose—retirement—can lead you to find real solutions that will ultimately create, rather than destroy, future wealth.

Your debt situation is hopeless. Like many others, I used to think that most people could avoid bankruptcy if they really tried. Now, after writing about the issue for more than a decade, I'm not so sure.

I've heard from too many people who faced six-figure medical bills or credit card debt that totaled more than their entire year's salary. They could struggle for years and still never pay off what they owe. Some empty their retirement funds, drain their home equity, and scrimp for years without ever making an appreciable dent.

Sure, many of these folks could have avoided the fix they were in. But many were as much victims of bad luck as bad choices. And some made decisions that the rest of us would be hard-pressed to fault.

Paul, a military officer, found himself $70,000 in debt after his wife Debbie was diagnosed with breast cancer. The conventional treatments didn't work, so the couple opted for experimental therapies their insurance didn't cover.

For Paul, there didn't seem to be any choice: Go into debt or say no to the only hope his sweetheart had.

"Debbie didn't survive," Paul wrote me, "but I would do the same again in the same circumstances."

Richard's long slide into bankruptcy started when he was laid off from a defense industry job at age 47.

"I worked hard, was a company man, and did the 50-to-80-hour workweek week after endless week, for years," said Richard, who lives in California. "I soon found, however, that my defense-specific knowledge and skills were nearly worthless in the commercial world."

Richard eventually found work, but not before racking up debts that proved unpayable on his new, lower salary.

Dan and Leah were managing just fine until their young son developed reactive airway disease and landed in the hospital with pneumonia. Dan's employer fired him because he missed too much work while attending to his son; without health insurance, the medical bills had to be paid for out-of-pocket.

"We filed for bankruptcy, and that was very difficult," Leah said. "I remember crying at the courthouse. I felt like such a failure for not being able to take care of our own debt."

Of course, some people feel such a strong moral obligation to repay their debts—however they were incurred—that bankruptcy is not an option.

Many people, though, are simply ignorant of their alternatives or the true gravity of their situation. If anything, they wait too long before they file, continuing to throw money after impossible debts when they could be using that cash to rebuild their lives.

Bankruptcy court is meant to give people a fresh start while protecting their homes and retirement funds, to prevent them from facing a poverty-stricken old age. Bankruptcy should never be the first choice, but sometimes it's the best of very bad options.

How can you tell if it's the right option for you? In the next chapter, you'll see how to evaluate your financial situation, prioritize your debts, and find the expert advice you may need to make that decision.

Addressing the Ants as Well as the Grasshoppers

I'll never forget the father who wrote to me proudly detailing his progress at becoming financially independent. He and his wife were saving prodigiously for retirement, and they had a fat emergency fund. They decided that their next goal would be to retire their mortgage as early as possible. When he worked the numbers, though, he realized that accelerating the mortgage payments meant they'd have to cut way back on their vacation fund. They had long wanted to take a special trip with their daughter, who was 11. He asked me if I thought it wise to put off that journey until the mortgage was retired.

If you have teenagers, you will probably understand my response to him. Go on the trip now, I told him, while your daughter is still delighted to spend time in your company and you can really enjoy the trip as a family. Before you know it, she'll have all sorts of interests and friends that will make her reluctant to take a long trip with her folks, and then she'll be off to college. Seize the moment and go now. The mortgage will still be there when you get back.

That advice shocked a few folks, who presumed that it's always better to save than to spend. In reality, financial planning isn't about one or the other; it's about both. The hardest part of managing your money can be figuring out the balance between living fully today and preparing for the future.

Most debt advice is aimed at the grasshoppers—people with a "live for the moment" attitude. They wind up paying for every purchase two or three times over because they put it on their credit cards, pay just the minimum balance, and rack up prodigious interest charges over time.

But we shouldn't forget the many ants out there—people who may be erring on the side of living too much for the future. After all, life is not a dress rehearsal—it's the only one you've got. Make sure you live it along the way.

Debt-Free Is the Way to Be—Eventually

Although debt has its place, I'm not among those who believe that it's always better to use "other people's money." These folks advocate having a mortgage as long as you live because you can almost always invest the money at a higher rate of return than you're paying.

That may be true, but there's a strong psychological advantage to being beholden to no lender in retirement, when your income will likely be fixed and your ability to survive financial setbacks may be lessened. Knowing that their house is paid for helps a lot of older folks sleep soundly at night.

Summary

Let's review some important concepts that will guide you throughout this book:

- Debt is a tool that, if handled properly, can help you create wealth.
- "Good" debt can sink you as quickly as "bad" debt; you need to determine your own limits.
- Mortgage debt is some of the cheapest money you'll ever find and is usually the last debt you'll want to pay off.
- The order in which you should pay off other debt depends on your individual situation and goals—not one-size-fits-all advice.

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