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Overview

- o Review of Lecture #1 (a sneaky quiz!)
  - Bill Hybels, Willow Creek Church
- o Identifying Excessive Debt or Over-Commitment
- o Recovery Plan
- o Strategies for Debt-Free Living

Recall: Conclusions from Scripture:

- o Lending is not a profit opportunity. It is an *obligation* of the fortunate to the less fortunate "brother."
- o The lender has power over the borrower. "Power corrupts, and ..." Scripture placed moral restraints on the use (or prohibits abuse) of that power.
- o A borrower is in bondage. Don't Take Bondage Lightly. Escape. Quickly!
- o Christians not prohibited from all debt.
- o Other principles of Scripture guide our borrowing & lending.

Biblical Criteria for Evaluating Debts:

- o What was the **purpose** of the loan?
- o How much "**bondage**" is produced by the loan?
- How heavy the monthly burden: % of disposable income
- How long the commitment? 6 months? 30 years?

Biblical Criteria for Evaluating Debts:

- o Is the debt an **unwise** business decision? "A fool and his money are soon parted." Jesus said "Be wise as serpents and harmless as doves."
- o Risks assumed & consequences of "losing the bet"
- o The Esau Principle: Don't Sell Your Birthright!

The Root Issue for Debt: Spiritual and Financial Discipline

- o Debt is not wrong or un-Scriptural *per se*. But when we get into debt trouble, it almost always results from *a spiritual problem.* I know, 'cuz I've been guilty of it many times in my life.
- o It is all well & good to discuss the relative merits of various forms of debt. For the financially healthy and sophisticated, it is an interesting and profitable topic. But for anyone in *bondage* to debt, the solution is not picking out better debt instruments, or re-financing, or consolidating, or re-structuring, ... The solution is *debt elimination*. And that is not a financial exercise; it is a spiritual battle.

"Debt elimination is not a financial exercise; it is a spiritual battle."

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Definition:

- Debt happens when we consistently spend more than we earn.
- Question: why do we think we *can* buy something if we don't have the money in hand to pay for it?
- **Survey:** "Why in debt?" Answer: we "need" or we "have to have" or we "deserve" something. Says who?
  - Who set the "minimum standards" for our lifestyle? We all need food, shelter, sturdy walking shoes, 2 changes of clothing & a Bible. I guarantee that no one with a $6,000 unpaid balance on their Visa card ran up that bill buying only the bare necessities.
  - Who tells us how expensive a car we "deserve"? Who tells us how big a house we "need"? Or how desirable a neighborhood? Who tells us "you deserve a break today"? (The Business Principle)

Why is the love of money the root of all evil? Because love of money is based on the falsehood that our happiness comes from material things.

- Scripture tells us a million different ways that is not true. At noon on Sundays, we know this. By Monday morning, many of us forget.

The cure for debt bondage is not short-term, and it is not financial. It is longterm & spiritual.

- Understand where true happiness comes from.
- Value financial sanity more than instant gratification, status, or convenience.
- If we can't control our spending, we must name it what it is — compulsive over-spending — and seek treatment for our disease.

Identifying Excessive Debt or Over-Commitment

- How do we know we have a debt problem?
  - Buggs Island Lake & Dam
  - Key measure: *Not* how much debt you have at the moment, or what form it is in. Key measure is: how has your debt load *changed* over the past 1-2 years, and why?

Example:

- new house, bigger mortgage, zero consumer debt

Example:

- just graduated, large student loans, aggressive repayment plan

Example:

- no major life changes, but every routine "crisis" increases the unpaid credit card or HELOC debt.

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Example:

- o debt consolidation loan in past 1-2 years, still buying on credit, no aggressive repayment effort.

If we have a debt problem, what should we do first?

- o Good Samaritan with-a-twist: plastic surgeon, severe beating, leg artery with 1 quart on the ground.

Stop the Bleeding!!

- o Before you can get healthy, you have to stop bleeding to death.
- o When you're severely off course & getting further astray, nothing gets better until you turn around.

Recovery Plan

- o Step 1: **Spend *significantly* less than you earn**
  - If we *weren't* in trouble, we should be spending 5%+ on investments, 5% on debt service, 5% on savings = 15% of our gross income on improving our financial picture. But we *are* in trouble, so we should aim for 20% or more of our gross for remedying our financial disease. 15% is bare minimum.

(Gasp!)

- o "But we can't live on our income now. We can't possibly live on 20% less!"
- o Yes, we can, but we haven't been. Until this changes, *nothing else* will change. Guaranteed.

Sacred Cows

- o What should we stop spending on? Whatever is less important than financial sanity & freedom from bondage. This is a severe problem, and it requires a severe solution.
- o Perhaps our housing, food, travel, etc. budgets are all fine, but we suffer from impulsive spending on "stuff." Perhaps all we must do is put the credit cards away, severely restrict "walking around money" and that will generate a 20% debt retirement fund.
- o Perhaps we bought a house that is way too expensive for our income, and it is gobbling us up. It may be necessary to get out of that house and live (for a few years) in a dramatically cheaper home.
- o Perhaps we bought a nice car so we could avoid the indignity and inconvenience of public transportation, but those transportation costs make it impossible to generate a 20% debt retirement fund. Perhaps that car has to go.
- o Perhaps all your avoidable expenses are justified by the sacred cow of the American Family: "it's for the kids." There is something your kids need more than summer camps, private schools, cool clothes, etc. They need parents that teach

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them how to live responsible lives. Or else they'll inherit your struggle when they grow up. Is *this* what you want for them?

Mission Trip to Turkey

- If you went on a mission trip to Turkey, or the Dominican Republic, and lived in rude dwellings with hardly any of your familiar creature comforts, you wouldn't die. In fact, you might come back praising God for the spiritual growth and insights gained amid all that deprivation. "But that is temporary" you may say. So is debt recovery.
- Ask any couple married more than 10 years if their home etc. is nicer now than it was during their honeymoon year. Then ask them if they were happy during their honeymoon year.
- Happiness does not come from stuff. It comes from following God's plan for our lives. And God does not want His children in bondage.

Step 2: Attack your debt via "Cascading Payoffs"

Jim & Julie's Debts

Cascading Payoffs

- Mathematically, it seems the first debt to attack is the one with the highest interest rate.
- Spiritually and emotionally, another strategy is better: attack the lowest balance first. Why? Because it is the quickest path to a tangible, significant victory — paying off a debt. Success is encouraging and strengthens us for more success.
- On Jim & Julie's debts, I would argue for 2 exceptions to the "lowest balance first" rule:
  - a subsidized student loan is cheap credit; pay it off last.
  - the signature loan is second-lowest balance, but the MasterCard is almost as low, and that interest rate is obscene. Kill it off 2nd.

Jim & Julie's Debts

- Chart shows Jim & Julie have taken an axe to their spending; they will devote \$792/month to debt recovery. \$399 is required to make the minimum payments on their 6 personal debts, leaving \$393 extra to attack their problem.
- NOTE: I was lazy & did not re-calculate interest accruals on rapidly declining balances – All numbers in this example will be rough approximations to demonstrate the method of Cascading Pay-Offs. As professors always say "Calculation of the precise numbers is left as an exercise for the student." PS: the precise numbers will show an even *faster* payoff than my approximations.

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Month 1 pay $515 on the bank note.

Month 2 pay bank note off with $431, and put extra $74 on MasterCard ($98 total). (Both credit cards have been scissored.)

Month 6 pay (393 + 122 + 24 =) $539 on MasterCard each month.

- Note that our "debt reduction ax" remains constant at $792/month, but as we continue to pay off loans, the portion of that $792 available for "extra principal" payments keeps growing.
- Will there be pressures some months to say "we need to 'borrow' some of the ax for a very important purchase"? Count on it. It is essential to build a high wall around the ax and *force* yourselves to live on the other 80% of your income. *And* to prohibit any more borrowing no matter what. It becomes a challenge – an exciting game. "Throw a crisis at me – go ahead. With God's help we can find a creative way to handle the crisis without borrowing and without reducing the debt reduction ax."

Month 7 pay (539 + 88) $627 on Signature Loan.

Month 8 pay off Signature Loan ($18) and pay $629 on Visa.

Month 11 attack Visa and wipe it out.

End of Year #1: A celebration is in order!

- Four personal loans have been eliminated – 2 of them with stifling interest rates. The debt-reduction ax has grown; they can now pay $733 a month on their HELOC.
- Jim & Julie do the math; 18 months to pay off the HELOC. That's a long time. A year ago, the prospect of chipping away at a debt for 18 months would have overwhelmed them. But they are now victorious warriors doing clean-up operations – they know the battle is won if they just keep on keeping on.

2 Years & 9 Months

- After the HELOC they decide to kill off the auto loan, saving their subsidized student loan for last. In less than 3 years, Jim & Julie owe nothing but a primary mortgage. And their shoes are getting *very* old. For their anniversary, Jim gives Julie a BEAUTY SHOP perm — first one in 2.5 years! But they're free!

Reality check:

- Jim & Julie were lucky; they faced their problem before it got any bigger. If they had been in a bigger hole, they might have needed to make more dramatic changes to get their monthly spending under control and create a debt-reduction ax.

o Their spirits responded to the call of financial freedom; Jim needed some counseling at first to help them get started, but once he saw their debts as threats and gained *power* over those threats, his natural instincts kicked in. He made heroic efforts to protect his family from danger.

Step 3: Establish reserves and sinking funds

o The celebration is intense when the last payment is made on the HELOC. But they realize they're not done. They have stopped the bleeding and dressed all the wounds, but they still aren't completely healthy. Why?

What is a Sinking Fund?

o By God's grace, their aging car is still running with only routine maintenance. No major appliances broke down while they were digging their way out of debt. But they know a maxim: *All possessions are expenses waiting to happen.*

o Accountants have a name for this reality: a sinking fund.

o If a car that costs (net) $15,000 will be reliable for 5 years, that is a cost of $250/month: that's how much car you use up each month. If you finance the car, you have to add $38/month to that cost for interest. But if you become your own banker, paying cash for that car, you can subtract $20/month because your interest earnings on your "sinking fund" will accumulate. Or you could upgrade the car each time with your interest earnings.

o Likewise for washers, dryers, furnaces, A/C, roofs, etc.

o Unless you have sinking funds and reserves for the expected costs of replacing durable goods, your escape from debt will be only temporary. Stuff breaks. Plan for it.

Jim & Julie's Sinking Fund

o They use their $1,000/month debt retirement "ax" (plus a raise) to quickly build their reserves to where they figure they should be (based on age, service life & cost of each major item).

o At the end of their 4th year, they are not only completely free of nonmortgage debt, but they are confident that *when* stuff breaks or the time is right to replace a major item, they will not go back into bondage.

Step 4: Save and invest for the future.

o With a sense of control over their expenses and adequate reserves for emergencies, Jim & Julie can finally begin to really address their goals and dreams. Like college for the kids!

o Even while climbing out of debt, they were smart about the future. Jim contributed enough to his 401(k) program to get the full employer match. *Always take free money*.

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o Now, Jim decides to max out his contributions to the 401(k). Julie is working part-time, and they max out her tax-sheltered retirement funds, too. This generates tax savings for both of them.
o The retirement contributions and some savings (on top of the sinking funds) consume part of the "ax" they had been using to eliminate debt and establish reserves. Frankly, they have gotten used to living on a fraction of their income, and the privations that chaffed so much at first they have either learned to live with or found ways to overcome without excessive spending. They decide to relax their spending rules *a little* but they want to use the rest of their monthly ax to aim at their dreams.

Strategies for Debt-Free Living

Foundation: Valuing Freedom more than Stuff

o "So when the woman saw that the tree was good for food, and that it was a **delight to the eyes**, and that the tree was **to be desired** to make one wise, she took of its fruit and ate, and she also gave some to her husband who was with her, and he ate." (Gen 3:6)
o "But every man is tempted, when he is drawn away of his own lust, and enticed." James 1:14
o Recovering alcoholics never lose their desire for a drink; they just discover there is something that they want more — a sane life.
o We will always want things. The trick is to truly value financial freedom more than current pleasure.

Bootstrapping

o Discipline + patience + sinking fund = Control over our circumstances. But how do we get started?

Auto example

o Budget guidelines tell us how much we can devote to a car.
o Find an ugly-but-reliable car you can pay for in 1 year, but drive 3 years. In years 2 & 3, pay into your sinking fund (= double price of the car).
o After 3 years (longer if you are blessed), put auto sinking fund + 1 year loan into a less-ugly-but-very-reliable car. Repay loan in 1 year. For next 3 years pay into *sinking fund*. (Why that fund?)
o After 7 years, replace cars whenever it makes sense, spending only the available balance in the *auto portion* of the sinking fund. The longer a car lasts, the more you have to spend on the next one.
o If at any time you lust after a snazzier car, increase your sinking fund contributions ... and *wait.*

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Housing example

- Budget guidelines tell us how much we can devote to housing. That is our monthly mortgage payment.
- Use Loan Calculator to determine how large a mortgage you can afford with that payment with a *10-year pay-off.*
- When a banker or realtor says “Oh, you can afford *much* more than that”, recite Matthew 16:23b. “Get thee behind me, Satan: thou art an offence unto me: for thou savourest not the things that be of God, but those that be of men.”
- Buy a modest home with that mortgage. Live in it for 10 years.
- After 10 years, sell your home (mortgage-free), use proceeds plus a new 10-year mortgage to buy a comfortable home.
- After 20 years, your home is debt-free. Your second 10-year mortgage was probably bigger than your first one because your income went up. But you weren’t saddled with a back-breaking mortgage your first 10 years.
- At this point you’ll wonder what to do with all that extra money. Then your kid will be accepted to M.I.T. Hold that thought 4 years.

Objections

- “But if I buy a bigger house the first time (with a longer mortgage amortization), I can ride the real estate wave on a bigger home and make more money in the long run.” *True.* If the market goes up. If it goes down, you lose more money. And there are *lots* of other factors: rate of appreciation in different neighborhoods & price ranges. If you tweak the strategy to suit your needs and views, GREAT!
- Why should I buy less house than I can afford?
- But I *want* it .. You choose: bondage or freedom

The “extras”

- Perhaps fancy cars and huge houses don’t tempt you at all. But a really nice vacation! Wow! That would be *worth* a little debt bondage, wouldn’t it? Well, would it?
- There is *no conflict* between a strategy for debt-free living and nice vacations, or boats, or summer camps for the kids.
- Only one restraint: when plotting how to acquire what you desire, borrowing is not an option. Aside from that, *go for it!* The truth is, if you pursue debt-free living, you will have financial discipline and the habit of planning. You’ll probably be more capable of having the extras than your debt-ridden friends. And you’ll enjoy that cruise more, knowing that you paid for it before you left home.

The Heintz ketchup principle

- The American credit industry is built on instant gratification. Buy now, pay later. It profits from human weakness. And we all understand there is a certain childish pleasure in venting our inner 2-year-old: “I want it, and I want it *now*.”

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- There is a contrary principle in human psychology: the pleasure of anticipation. A goal achieved through patient effort takes on an extra luster.
- The bedroom suite.
- The old commercial for Heintz ketchup made a good point. “It’s slow good.” Something really good is worth waiting for. And it *really does* taste better.
- The ultimate irony is this: we get into debt bondage when we indulge our craving for instant gratification. But that deprives us of an even greater pleasure. A wise person who seeks great satisfaction in life learns patience. The wise man builds his house on a rock, and is safe, free and happy.

The First Step

- *Must* begin by bringing spending under control. *Stop the Bleeding!*
- Compulsive over-spending is a disease. Millions of Americans have it. Quote from AARP Magazine: “Consumer debt for car loans and credit cards reached $2.18 *trillion* by 6/30/06. Americans for the first time have more debt than disposable income, and households carry an estimated average of $7,253 in credit card debt alone. Meanwhile, the savings rate in the second quarter 2006 was the second lowest since the Depression.”
- There is help.

There is help

- Debtors Anonymous
    - http://www.debtorsanonymous.org/
    - 1-877-717-DEBT
- Overcomers Support Group
    - Tenth Presbyterian Church, Thursday at 7:00pm
- Deacons’ Financial Counseling

Deacons’ Financial Counseling

- jroberts843@earthlink.com = Contact Point for Deacons
- Describe your situation:
    - Parish & Location
    - Age & Marital Status
    - Contact info & schedule constraints
    - Any details re: the financial issues
- You *will* receive help.

Questions?