How Much Is Enough?

◆ Issue #26 ◆ Douglas E. Reese

Normal vs. Debt Payment Schedule

The concept I'm going to share with you this month may be the most powerful financial planning technique I've come across in my 15 years of money management experience. So, I recommend that you listen very carefully. This idea can change your thinking about your current financial situation. It can free you up from the emotional bondage that money can create, and it can show you a way to financial independence much sooner than you may think is possible.

Let's begin by reviewing last month's idea…I recommended that you take the time to complete the "Debt Freedom Schedule" enclosed in last month's issue. If you have done this, then you have a good idea of how much personal debt you now have, what interest rates you're paying, and how much you have to pay in total each month to service the debt. If you have not completed this exercise, I strongly suggest you do so. To clarify my point, I'm enclosing two completed schedules in this month's issue, as examples to be used in developing my concept.

Last month, I opened with a definition of "financial independence." I suggest that it is a point in time when your savings provides income to cover your lifestyle, without the need to work. This is difficult to achieve when you're carrying excessive amounts of debt. So, a first step is to know when you intend to be out of debt. In the examples I've enclosed to calculate this, I assume the person is 45 years old (let's use the name Dr. X) and has 6 forms of personal debt. Dr. X is paying on a Visa, Discover, Line of Credit, 2 auto loans, and a house mortgage, with a total debt balance of $127,700. His interest rates range from 19.3% down to 7.25%, and his total monthly payments are $2,720.

Let's look at example #1 on the next page, the "Normal Payment Schedule." Under this schedule, Dr. X will pay $45,850 in interest and will be debt free in 11 years and 7 months, just before his 57th birthday. At this time, he has no retirement plan in place and a lifestyle that requires $60,000 in take-home income annually. This is a very typical scenario I find when I begin work with an individual. You'll notice I placed the words "normal payment schedule" in quotes. This is based on many financial planning sessions and much research where I've discovered that it is the American way that once we are rid of a debt payment, we take that freed-up money and put it towards a better lifestyle. And, that is what this example shows.

However, under example #2 or the "Debt Freedom Schedule," Dr. X will pay <u>$22,940 in interest and will be debt free in 4 years and 8 months</u>. This is an <u>interest savings of nearly $23,000</u>, and the Dr. is <u>debt free nearly 7 years earlier than example #1</u>! My technique for achieving debt freedom much sooner does not include any magic…only self-discipline. I'm suggesting through this example that when you finish paying off one piece of debt, you take that money and immediately begin paying down another debt. (I recommend that you choose the debt with the next highest interest rate.)

The two scenarios are drastically different in terms of the timing of financial independence. I will spend more time developing this concept in next month's issue. Until then, if you have not taken the time to write out your current "Debt Freedom Schedule," I highly recommend you do so. And, take it a step further. Each time you finish paying off one debt, the next month begin applying that payment to the next highest interest rate piece of debt you have. This future projection does not have to be exact, only an estimate.

I feel strongly enough about the value of this one technique and its potential impact on your personal financial stewardship, that I will make you this offer. If you have trouble projecting your debt payment schedule into the future, I'd be glad to help you. Call me (303-738-1698) or fax me (303-738-1686) your debt summary along with each debt balance, interest rate, and current monthly payment. I'll help you sort it out.

Next month, we'll begin developing this technique further. And, we'll look into ways of freeing up your financial future, clarifying when you are likely to be financially independent, and exploring ways of helping you arrive at that point in time as quickly as possible, in conjunction with your maintaining a quality of life you desire.

"Life's Short…Plan Well."

Example #1 **"Normal Payment Schedule"**

BALANCE	2,700	3,400	3,000	17,500	15,200	85,900	
DATE	Visa 18.7% DEBT #1	Discover 19.3% DEBT #2	Crdt Line 14.3% DEBT #3	Auto Note 9.5% DEBT #4	Auto Note 9.0% DEBT #5	Home 7.25% DEBT #6	TOTAL PAID/MO.
Jun '96	500	250	200	450	420	900	2,720
Dec '96	PD-IN-FULL	250	200	450	420	900	2,220
Oct '97		PD-IN-FULL	200	450	420	900	1,970
Nov '97			PD-IN-FULL	450	420	900	1,770
Dec '99				450	PD-IN-FULL	900	1,350
Apr '00				PD-IN-FULL		900	900
Jan '08						PD-IN-FULL	0
Paid in...	6 mo.	1yr./4mo.	1yr./5mo.	3yr./10mo.	3yr./6mo.	11yr./7mo.	
Int. paid...	109	392	281	3,215	2,403	39,450	$45,850
Total paid...	2,809	3,792	3,281	20,715	17,603	125,350	$173,550

"Debt Freedom" is achieved in 11 years, 7 months at December, 2007. Total paid to debt is $173,550. Interest paid is $48,850. The assumption in this example is that each time a debt is "paid-in-full" the freed-up payment gets spent in future months on "improved lifestyle."

Example #2 **"Debt Freedom Schedule"**

BALANCE	2,700	3,400	3,000	17,500	15,200	85,900	
DATE	Visa 18.7% DEBT #1	Discover 19.3% DEBT #2	Crdt Line 14.3% DEBT #3	Auto Note 9.5% DEBT #4	Auto Note 9.0% DEBT #5	Home 7.25% DEBT #6	TOTAL PAID/MO.
Jun '96	500	250	200	450	420	900	2,720
Dec '96	PD-IN-FULL	750	200	450	420	900	2,720
Mar '97		PD-IN-FULL	950	450	420	900	2,720
May '97			PD-IN-FULL	1,400	420	900	2,720
Mar '98				PD-IN-FULL	1,820	900	2,720
Aug '98					PD-IN-FULL	2,720	2,720
Feb '01						PD-IN-FULL	0
Paid in...	6 mo.	9 mo.	11 mo.	1yr./9mo.	2yr./2mo.	4yr./8mo.	
Int. paid...	109	282	229	1,787	1,893	18,640	$22,940
Total paid...	2,809	3,682	3,229	19,287	17,093	104,540	$150,640

"Debt Freedom" is achieved in 4 years, 8 months at January, 2001. Total paid to debt is $150,640. Interest paid is $22,940. The assumption in this example is that each time a debt is "paid-in-full" the freed-up payment gets applied to the next highest interest rate debt owed.