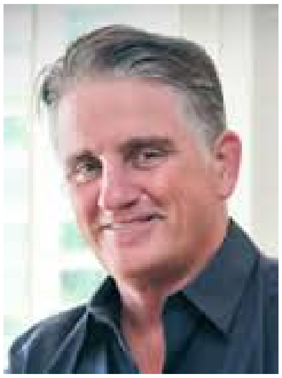

A Self-Made Millionaire's Guide to Dealing with Debt

By Mark Ford, wealth coach

I had my first serious run-in with debt when I was 30 years old. My wife K and I were renting a condominium in Washington, D.C. Our landlady came to us with an exciting opportunity: We could buy the condo for $60,000 with no money down. For just $100 a month more than what we were already paying for rent, we would be paying a mortgage. It sounded like a great deal, so we took it.

What we bought was a negatively amortizing mortgage with a three-year term and an 11% interest rate. That meant, every three years we were paying $19,800 in debt service and another $3,000 in closing costs.

We didn't realize what was going on because our monthly payments were only $550. I was too foolish then to ever ask myself, "What is the cost of this debt?"

I tried to find another bank to take me out of this scam but none would. The mortgage we had signed was not backed by the government (Freddie Mac/Fannie Mae), which meant that no other bank would touch it.

I learned that when banks make it easy to borrow money, it's not because you are a nice, deserving person. I learned that if you can get a loan despite poor credit (as ours was at the time), there is usually a scam involved. It also taught me to always ask the two critical questions about debt, "How much will it cost?" and, "Can I afford it?" It was an expensive lesson.

Many of us view debt as a necessity. We buy homes with it. And cars. And boats, and toys, and vacations. Some use it to buy the basics: clothes, food, and furniture.

Debt is not necessary. It is a luxury. Sometimes debt is useful. Sometimes it is wasteful. But debt is always dangerous.

It is unnecessary because there are always less expensive ways of getting what you want. And it is dangerous because it can sometimes be very expensive.

Let me give you two examples.

Let's say that, like most Americans, you are in the habit of buying things with credit cards. After a while, you notice that you have accumulated $30,000 in total debt. You decide to cut up your cards and repay your debt. You can devote $400 a month to paying it back. How long will it take, and how much will it cost you?

The answer may surprise you. Assuming an interest rate of 10%, it will take you 10 years to pay off the credit card debt. And your total payments will be $47,275. Of that, $17,275 will have been in interest payments.

Or let's take a $150,000 home on which you take a $120,000 loan with a 6.5% interest rate over 20 years. The mortgage payments are $894 a month, which you can afford. But how much will that house really cost you? Including interest payments? You will end up paying $244,725 for that house. Almost 40% of that – $94,725 – will have been to interest payments.

The commercial community (bankers and manufacturers) doesn't want you to be afraid of debt. And neither does the government. These institutions want you to like debt. They want you to use it. They want you to go into debt because it is good for them.

When you take out a mortgage to buy a home, or sign a lease on a car, or use credit cards to pay for your lifestyle expenses, the commercial community profits. The manufacturers make money on products you may or may not need. And the banks make money on your debt.

The mainstream financial media rarely talks about the dangers of debt. That's because they make their profits from the financial institutions and manufacturers whose advertisements support their publications.

And the government actually encourages its citizens to take on debt. This was the recommended strategy for getting us out of the Great Recession that the (second) Bush administration (and the Federal Reserve) advocated and it's the same scheme that Obama's people are advocating today.

Here's what you should know about debt:

As a general rule, you should live without it. You should find less expensive ways to acquire the things you need.

Unless you are wealthy, don't lease your car. Buy it. Buy the car you can afford, not the car you believe will make you happy. Any non-appreciating asset (such as a car) will never make you happy if you have to pay its debt service. I didn't buy my first luxury car until I was a multimillionaire.

Don't buy anything with a credit card. Keep only one credit card for renting cars. Use a debit card to buy clothes and groceries. If you don't have enough money in your bank account to use your debit card on a purchase, don't buy it. If you don't have enough money in the bank to buy something, it means you can't afford it.

If you can't afford the debt on your house, sell it (if you can) and buy something cheaper. In any case, start paying off the principle balance of your house (the amount you owe, not the interest you will owe) as fast as you can. Make it a goal to own your house free and clear as soon as possible.

If you have debt, pay it off as fast as you can, but not before you have filled up your bucket for emergency savings. By emergency savings, I mean money you will need to pay your bills if you lose your job. Six months' income is what some financial advisors recommend. I'd recommend a year. It may take you that long to replace your lost income.

Pay off your debt even if the interest rate is low. In theory, you should put your extra money elsewhere if you can earn more on it than you are paying in interest. If, for example, you can get 4% in municipal bonds and you have a student loan at 2%, it makes more sense to buy municipals bonds and pay your student loan off slowly. But in reality, the extra 2% you are earning on the spread is not worth the risk in carrying the debt.

When I started earning money, the first thing I did was get rid of that terrible loan on the condominium I told you about earlier.

The next thing I did was pay off the mortgage I took on a home. I paid it off in two or three years, even though it was a 30-year mortgage. I loved the idea of owning my home free and clear. So I put every extra dollar I had toward paying down that mortgage. The bank didn't like it, but the day I tore up that mortgage... I felt like I had been emancipated from financial slavery.

Finally, if you are troubled by debt, know this: you can get out of it just as I did.

A Three-Year Plan to Achieve Financial Independence

I recently received an e-mail from Jorge Izquierdo, Jr., who complained that "all the material being covered in my advisory service is for long-term investing. What about short term? I've been trying to free my family and myself from the chains of slavery for far too long now. Show me the truth."

Behind Jorge's question lies the assumption that it is possible to acquire wealth through some "short-term" investment strategy.

As I've explained before, it's simply not possible to quickly turn, say, $25,000 into $1 million by investing in stocks. But I have good news for Jorge. He can unshackle himself from "financial slavery," as he calls it, in a relatively short period of time.

Jorge – or just about anyone for that matter – can achieve freedom from financial slavery in just a few years. It does not have to be a lifelong process.

If you are in this situation, here is what you must do...

First, you must ask yourself if you are willing to give up the hope of getting rich quickly by investing. Are you willing to accept the fact that you won't go from broke to being a millionaire by investing in the next Microsoft? If you can't honestly and completely answer "yes" to that question, you might as well go read another analyst... one who will tell you what you want to hear.

But if you are ready, the next thing you need to do is think about what you mean by "financial slavery."

What does that term mean? Most commonly it means two things:

- You earn less than you spend.
- You owe more than you own.

If you earn less than you spend, you are in a constant state of stress. You must put off or partially pay your bills. You must appease creditors. And all the while, your debt is mounting.

If you owe more than you own, you can't buy a house or lease a car or get a loan from anyone other than your parents. (And what if they are dead or tired of helping you... or don't have the money?)

Because you are in so much trouble, you can't even think about taking nice vacations or retiring someday. Instead, you have to worry about losing your job. So you keep working and reading investment newsletters. But as each month passes, your financial situation gets worse.

It's a miserable existence. But it doesn't have to last. You can break the chains you feel attached to by simply recognizing and reversing the two "facts" mentioned above.

Problem No. 1: You earn less than you spend. Solution: Spend less and earn more.

You can't break the chains of slavery without hitting them hard with a big mallet. You won't be able to gain the independence you want in a few years or less by cutting $10 here and $50 there.

My recommendation is to cut your expenses by 30% to 50%.

I know that sounds crazy. And it may be impossible in your case. But don't dismiss the idea until you hear me out.

The primary factor in how much you spend every month is the neighborhood you live in. Your neighborhood creates the financial culture that presents the spending choices you make. If you live in a community of million-dollar homes, you will be looking at new BMWs and Audis when it comes to buying or leasing a car. When you go out to dinner, chances are, you'll be spending more than a hundred dollars per couple.

Unless you live in a working-class neighborhood now, you can radically reduce your spending by moving into one.

I have friends and family members in this situation. They live in $350,000 homes in beautiful neighborhoods and drive luxury cars. But the reality is they are broke and getting poorer every month. They refuse to even consider the idea of downsizing, because they are simply too ashamed to do so. What they don't realize is every month they try to "hold on," it is making them poorer.

Moving to a less expensive neighborhood would be the quickest, biggest, and surest way to bring their spending down by 30% to 50%.

The other thing you must do to improve your situation is to earn more money. You should take immediate steps to increase your income by 20% to 50%. Again, I know that seems radical, but if you want a "short-term" solution out of financial slavery, this is just as important as radically cutting expenses.

Problem No. 2: You owe more than you own. Solution: Start owing less and owning more.

If you have accumulated a lot of debt, it means that you don't see debt as financially dangerous. You must accept the fact that most debt you have is bad for you. There are only a few exceptions: mortgage debt when interest rates are low, and business debt when the business is sound and you are not personally liable.

The first step toward debt management is to get rid of every credit card you have, as well as any credit you have with your bankers. Use cash or debit cards for your shopping. Yes, that means there will be lots of things you can't buy every month. That's a good thing, not a bad thing.

If you have a lot of existing credit card debt, you need to consolidate it. Then work with a professional to pay it off at reasonable interest rates.

If you are lucky enough to have equity in your home, trading it for a cheaper one (see above) will accomplish two important goals: it will reduce your monthly expenses, and it will give you a chunk of cash that you can use to pay off debt or put aside as savings.

You must also increase what you own. And by that, I do NOT mean cars or boats or furniture or toys. I mean tangible assets that are likely to appreciate. Gold coins, income-producing real estate, and safe stocks belong in this category.

Every extra after-tax dollar you make by taking on extra work or starting a side business should be devoted to increasing your ownership of such assets. None of it should be spent.

Being financially independent is not about having a big house or driving new cars or taking fancy vacations. There are tens of thousands of Americans in that situation today who are financial slaves, just like you. They are in chains because they spend more than they make and owe more than they own. Their stress is just as great as yours, even though they may make more money or have more toys.

Being financially independent means having more income than you need and owing far less than you own.

It means knowing that you won't be harassed by bill collectors or embarrassed at the supermarket. It means you have money put aside to take care of any emergencies that come up, and it means a savings account that gets substantially bigger every year.

Becoming a multimillionaire takes years. But breaking the chains of financial slavery can be done relatively quickly.

The hardest part is recognizing the chains that are binding you – earning less than you spend and owing more than you own – and deciding to do something serious about them.

Jorge, you have the plan in front of you now. It's up to you whether you follow it.

Regards,

Mark Ford