IDEAS That Work TO GET OUT OF DEBT

OVERVIEW

Debt slows down, and often blocks, our ability to achieve financial freedom. To put debt into perspective, it's important to understand God's attitude about debt. The Bible doesn't characterize debt as sin, but it does provide warnings about being in debt.

Consider what it says in Proverbs 22:7:

"The rich rule over the poor, and the borrower is slave to the lender."

Scripture is clear that we need to look to Christ for all our needs, but through debt, we allow ourselves to become a slave to the lender.

If you want to achieve financial success, you need to reduce your current debt and stop incurring more debt.

DEBT RATIO

You might ask, “How much debt is too much?” The mortgage-lending industry reviews two metrics before approving loans. One metric is called the debt-to-income ratio or DTI. The industry recommends that your DTI should be less than 35–40 percent. A person with a DTI over 35–40 percent may have a difficult time paying all their bills.

The other ratio used by the lending industry is the housing expense ratio. This is computed by dividing total monthly housing expenses by total monthly gross income. If the ratio is more than 28 percent, this also may indicate a potential difficulty to pay all your bills.

DEBT RATIO WORKSHEET

Debt-to-Income Ratio

Total Monthly Debt Payments		$ ________
Total Monthly Gross Income	÷	$ ________
	X	100
		________ percent

Housing Expense Ratio

Total Monthly Housing Expenses		$ ________
Total Monthly Gross Income	÷	$ ________
	X	100
		________ percent

Debt-to-Income Ratio (goal is less than 35–40 percent)

To compute this ratio, calculate your total monthly debt payments. Include mortgage or rent payments, credit card minimum payments, auto loan payments, and any other loan payments. Divide your total monthly debt payments by your total monthly gross income. Multiply this result by 100 to get a percentage.

Housing Expense Ratio (goal is less than 28 percent)

To compute this ratio, calculate total monthly housing expenses. Include mortgage or rent payments, interest, real estate taxes, homeowner insurance, and association fees. Divide your total monthly housing expenses by your total monthly gross income. Multiply this result by 100 to get a percentage.

DEBT SNOWBALL METHOD

One way to reduce your current debt is by using the debt snowball method. Many popular financial plans use this tool because it's easy, effective, and helps reduce interest charges by accelerating debt payoff.

To reduce your debt using the snowball method:

1. List your debts from the smallest balance to largest balance.
2. Make minimum payments on all debts except the one with the smallest balance—allocate as much money as possible to that one. Once that debt is gone, add these extra funds to pay down the next-smallest debt and continue making minimum payments on the rest.
3. Repeat this process as you plow through the remaining debts.

It's not an overly complex process, but it does take determination and willpower to stick with it. Writing it down can be a helpful and motivating tool to keep the end goal in mind. (I've included a worksheet at the end of this step to help you get started.)

The debt snowball has two great benefits. On one hand, it's an effective method to get out from under the burden of debt. On the other hand, once you have freed up money you were using to pay down debt, you can redirect those funds for retirement or other financial goals.

DEBT SNOWBALL METHOD

DEBT SNOWBALL WORKSHEET

List your debts from smallest to largest.

This is the amount of extra money you can use to pay down debt.

Debt / Creditor *Example*	Total Payoff	Interest Rate	Minimum Payment	New Payment (Minimum Payment + Extra Cash)
Credit Card	$1,800	19.5%	$55	$55 + $100 = $155
Car Loan	$5,000	5.5%	$250	
School Loan	$25,000	7.5%	$300	

After the first debt is paid off, use the extra funds to pay off the next debt.

~~Credit Card~~	~~$1,800~~	~~19.5%~~	~~$55~~	~~$155~~
Car Loan	$5,000	5.5%	$250	$250 + $155 = $405
School Loan	$25,000	7.5%	$300	

Debt / Creditor	Total Payoff	Interest Rate	Minimum Payment	New Payment (Minimum Payment + Extra Cash)