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FINANCIAL

MANAGEMENT

EMPOWERING CHRISTIAN BELIEVERS TO HONOR GOD WITH THEIR FINANCES

Baptist Foundation of Illinois

Debt Management

In this session, you will learn to avoid and eliminate toxic debt and manage responsible debt well.

Analyzing debt can be an uncomfortable task for many people. It can be overwhelming to look back on your past financial missteps.

But, ignoring debt won't make it go away. Don't beat yourself up. You can't change the past, but you can control what is in front of you, so start from there.
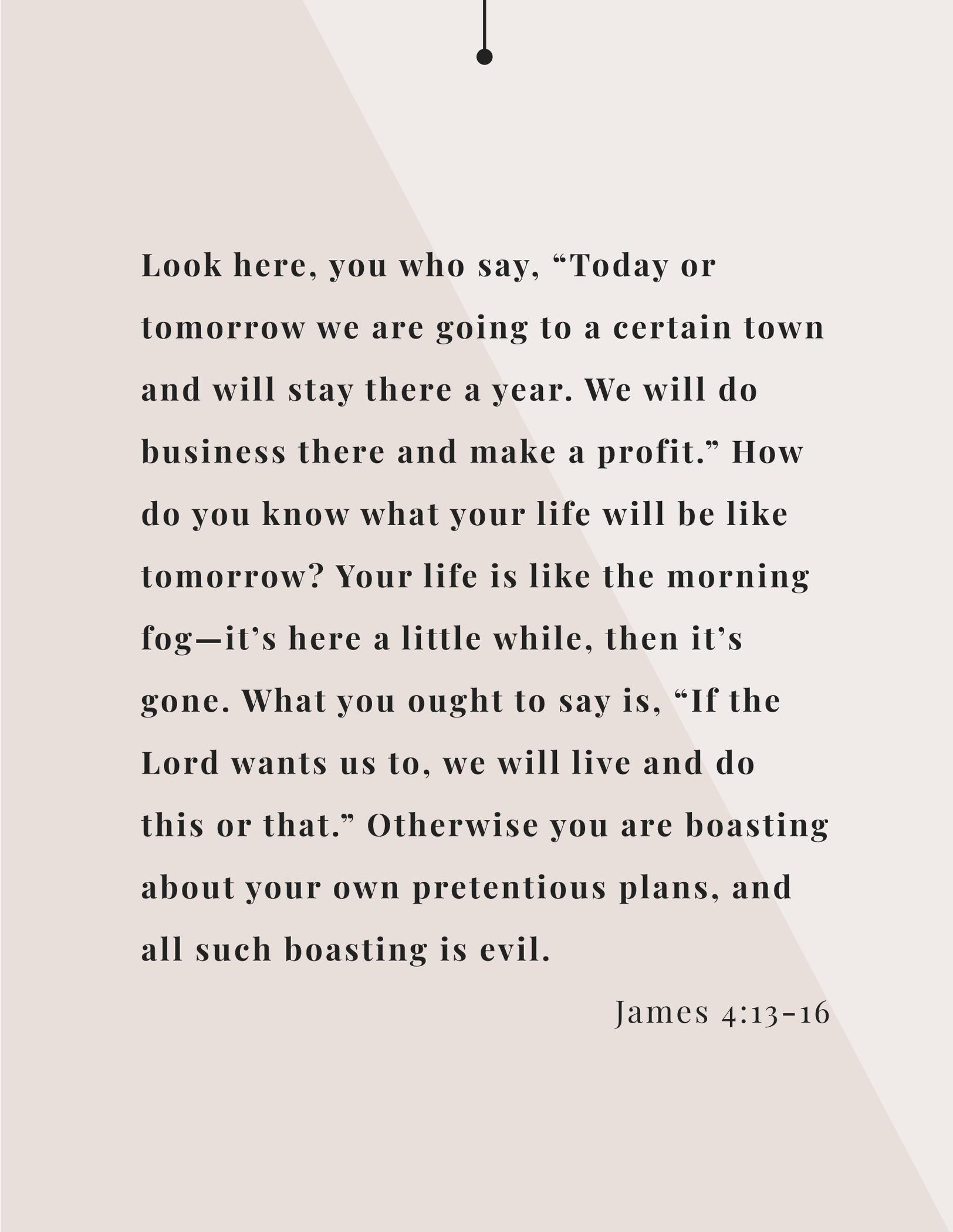
What feelings come to mind when thinking about your debt or taking on debt?
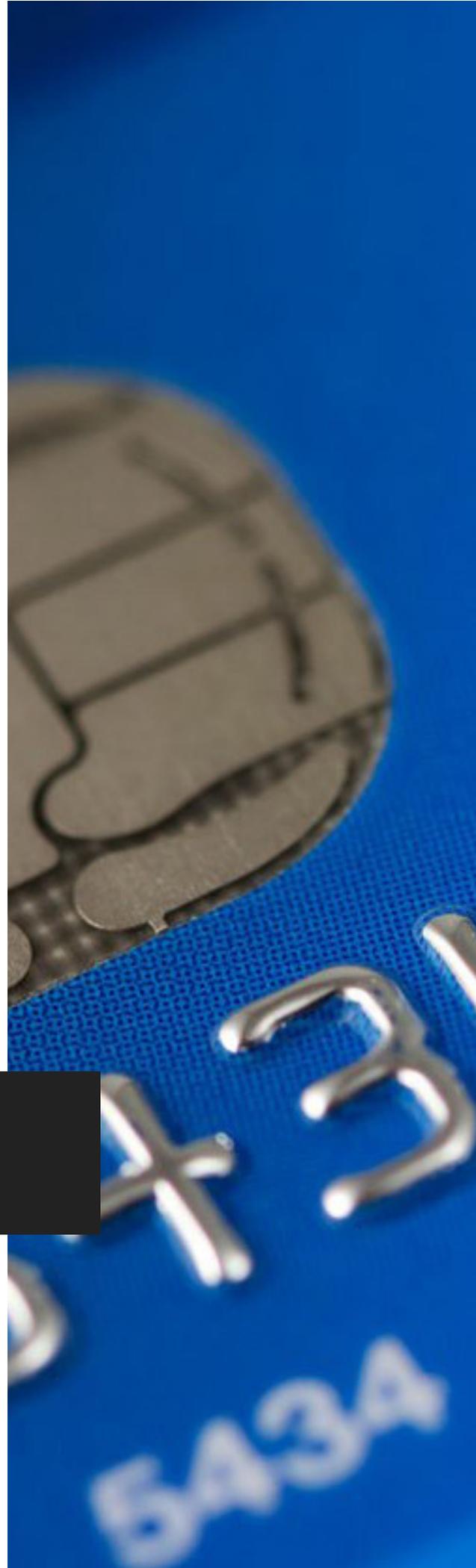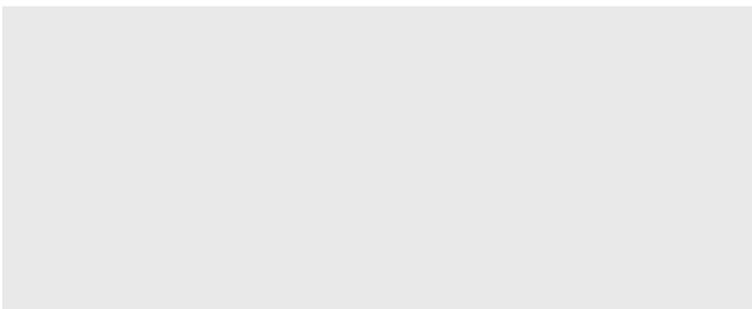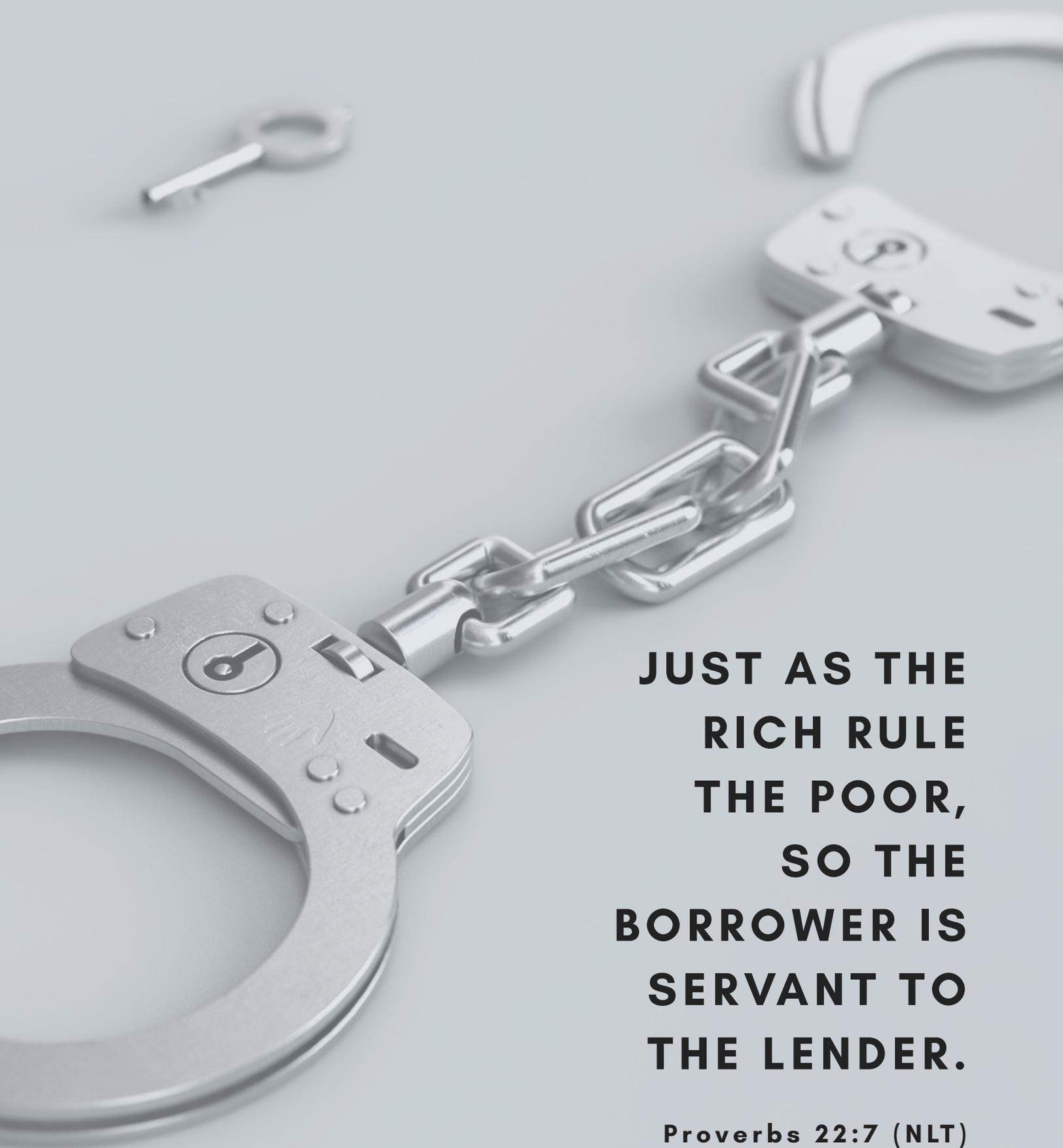
JUST AS THE RICH RULE THE POOR, SO THE BORROWER IS SERVANT TO THE LENDER.

Proverbs 22:7 (NLT)

Look here, you who say, "Today or tomorrow we are going to a certain town and will stay there a year. We will do business there and make a profit." How do you know what your life will be like tomorrow? Your life is like the morning fog—it's here a little while, then it's gone. What you ought to say is, "If the Lord wants us to, we will live and do this or that." Otherwise you are boasting about your own pretentious plans, and all such boasting is evil.

James 4:13–16

Debt Management

Don't assume you know what tomorrow is going to bring.

A reasonable take away from James 4:13-16 is that unsecured debt should be avoided as much as possible. Unsecured debt is any debt not backed by some form of collateral.

When debt is unsecured, we refer to that as toxic debt.

Toxic debt

- Credit card
- Personal loan
- Consumer debt

Acceptable

- Short term home mortgage

The key take-away is that acceptable debt doesn't assume on tomorrow. If you die unexpectedly with a balance on your mortgage, the debt is paid when the house is sold. If you die with a credit card balance, there is no equity and the amount is deducted from other assets. In other words, the term should be significantly less than the economic life of the asset itself. Of course the interest rate should be relatively low compared to the cost of inflation.

What toxic debt can be avoided in your budget?
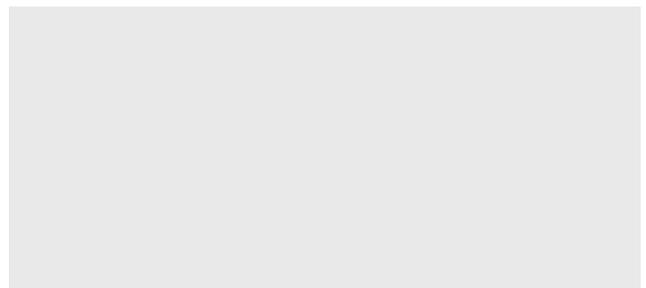
Helpful ratios for managing debt

Housing Ratio 1 (HR1)

Principal+ Interest+ Taxes + Interest (PITI) less than or equal to 28% of gross income.

- For example, if your average monthly income is $5,000, then PITI should not be more than $1,400.

Housing Ratio 2 (HR2)

Total HR1 + all other debt payments less than or equal to 36% of gross income.

- For example, if your average monthly income is $5,000, then the total of PITI and **all other debt** should not exceed $1,800.

Exercise

Look at the budget you created in session two and calculate your current housing ratios.

These are good ratios to review as you progress on your budgeting journey.

Steps to get out of toxic debt

1. Quit looking back at what you have done and look forward to what you can do.

Don't beat yourself up about the debt you have. That doesn't help you move forward and start knocking out this debt.

2. Break the behavior that lead to the debt.

It could be that you literally cut up your credit cards. Put up barriers to help you develop better habits with money and stop those behaviors that cause you to take on debt.

3. Set up a "crisis" emergency fund of $1,000

This fund will prevent you from reaching for a credit card when "life" happens. In John 16:33, we are promised that "In this world you will have trouble. But take heart! I have overcome the world." We are sure to have difficulty and problems during our lives. So prepare for these situations.

4. Set up a vanishing debt "snowball"

List out your debts form the smallest to largest. Start knocking out the smallest debt with your margin and keep making the minimum payments on all the other debt. Then as you pay off your smallest debt, roll that payment over to the next debt.