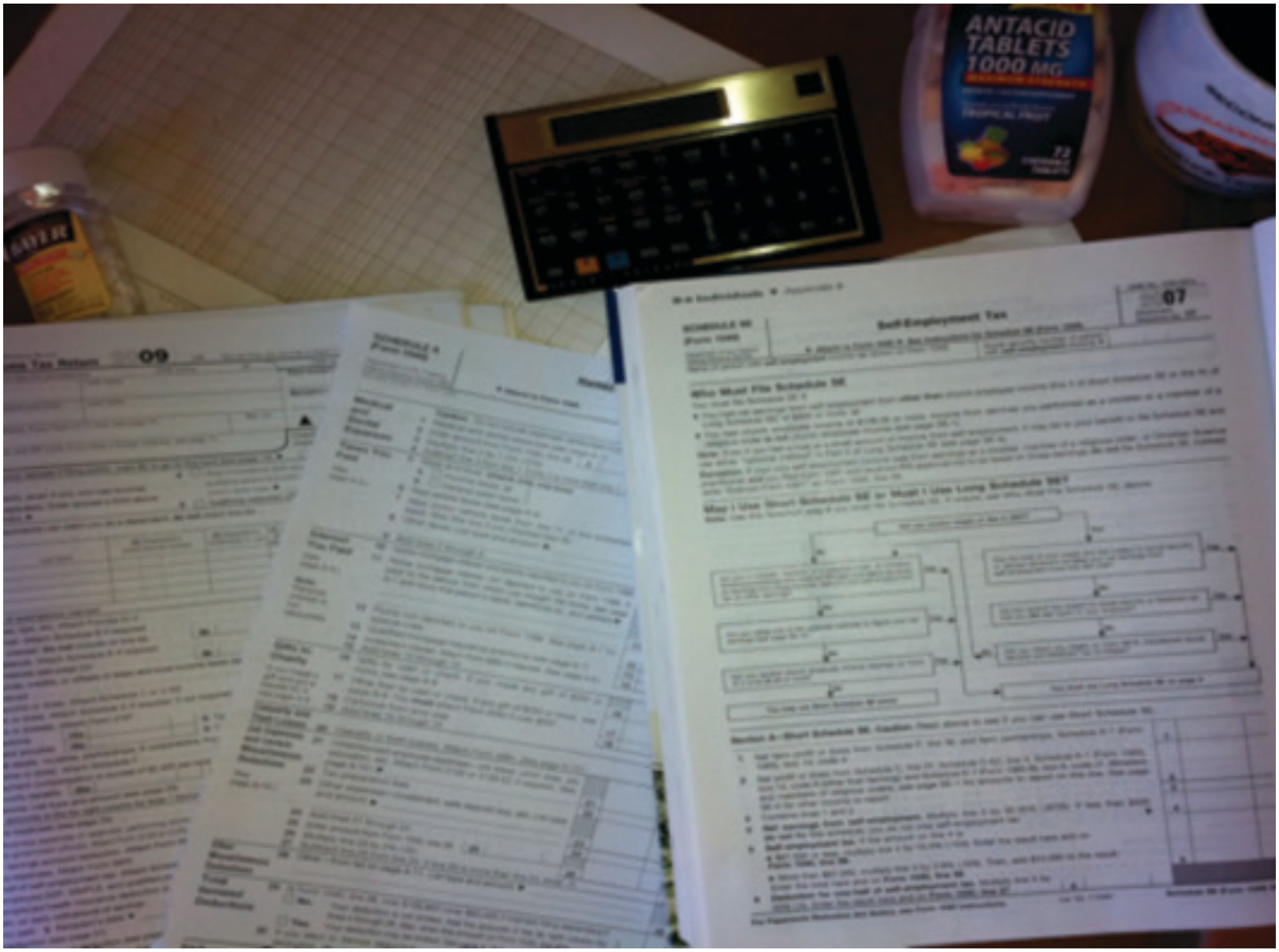
Karen Telleen-Lawton: Financial Planning Tips, Part Two — Pay Down Debt, Maintain Credit



Tax time is a good time to make financial resolutions. (Karen Telleen-Lawton / Noozhawk photo)

By Karen Telleen-Lawton, Noozhawk Columnist | Published on 01.07.2013 6:38 p.m.

What is the new year without at least one resolution regarding finances? In aprevious Noozhawk column ("From Anxious to Adept — Financial Planning Tips, Part One," March 26, 2012), I listed 10 financial planning tips and detailed the first one: Live within your means. The second tip — pay down debt and maintain credit — is particularly appropriate now, since the release in December of the 2012 Bad Financial Habits Survey by theAllianz Life Insurance Company of North America.

The survey of 1,000 respondents found that 30 percent admitted to “not saving any money” and 18 percent indicated they are guilty of spending more than they make.

In many cases, a major culprit in “not saving” and “spending more than you make” is debt. Our commercial society being what it is, it’s easy to get overextended. Sooner or later, the piper must be paid. Our natural preference — and a good goal — is to arrive at our golden years debt free. But if you’re ridden with debt, it can be hard to know where to begin. Here are some ways:

» Start with the highest interest rate debt. This sounds obvious, but in the moment you might be swayed by the loudest creditor or the smallest (or largest) balance. Paying off the debt with the highest interest rate first will save you real dollars.

» Don’t consider a loan to buy something when there is a substitute that you can afford without getting a loan. Buy a “pre-owned” car from a reputable dealer rather than leasing one. Buy a Ford instead of a Lexus. Buy a smaller house with 20 percent down and a low fixed-rate mortgage. What is affordable for you is what you can buy without credit, or (for a mortgage) pay each month without anxiety.

» Keep the length of any loan less than the life of the purchase. What I advise clients buying a car is to limit the loan length to no more than half the time they plan to own it. Then when the loan is paid off, set aside that same amount per month (or more) towards the purchase of the next car.

» Start establishing good credit in your 20s. Good credit means lower interest rates or may make the difference in being granted a loan when you need it. Good credit used to mean not having debt, but now it’s good to establish credit by keeping a small number of credit cards (one to three), using no more than one-third of the credit limit and paying each off in full every month.

» Pay off all debt by the time you retire. In retirement, your income is often fixed, so you want to reduce your fixed expenses below that level.

» Reduce the risk of bankruptcy and maintain good credit by 1) not spending money you don't have, and 2) insuring appropriately for catastrophic risks. Start by saving an emergency fund of at least six months worth of expenses for the inevitable bumps in the road. Insure for catastrophe such as a disability or loss of life to the wage earner, and know you're paying for peace of mind.

Easy credit smooths transactions and allows you to spend steadily even when your income is choppy. But it blinds us to understanding how much you can really afford. Ignore advertising and watch your wallet.

And that brings us back to doe: Live within your means — don't spend all your dough.

— Karen Telleen-Lawton's column is a mélange of observations spanning sustainability from the environment to finance, economics and justice issues. She is a fee-only financial advisor (www.DecisivePath.com) and a freelance writer (www.CanyonVoices.com). Click here to read previous columns. The opinions expressed are her own.