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Chapter Eleven

Debt Warfare
When Push Comes to Shove

Hello, I'm Push. I've come to Shove.

Ten Second Lesson: "If you are going through hell, go straight through." —Winston Churchill

You've seen it, right? It's almost a Hollywood cliché—the handsome hero is trapped in the abandoned warehouse without any weapons. Whether it's pure coincidence or formula writing, it always makes an exciting scene. Six or more "bad guys" stealthily hunt for our hero to slowly torture then kill him. Presently everything seems calm, perhaps there is some water dripping in the background. All of a sudden our hero lunges from behind a stack of boxes, grabs a bad guy [a bill] from behind and snaps his neck like a chicken. He then takes all of the weapons and ammo [money] from the body [paid bill] and moves on to the next bad guy. No matter that the next bad guy [bill] is bigger, now our hero has weapons. With each kill our hero grows closer to escape.

In our hero's mind there is absolutely no question all of these bad guys must die one by one. If he had the firepower [cash flow] to kill them all at once perhaps he would. These enemy bills have stalked, harassed, and embarrassed him, ruined his life, perhaps even caused family problems for him. As the music softens and crescendos we know the fate of the bad guys [bills] is sealed. Our hero has a well thought out written plan for this mission and he intends to carry it out.

Truly it is a simple concept—amass your money-troops and wipe out the smaller enemy-bills first, stripping them of their weapons and ammunition [extra income] as you go, constantly applying the freed up monthly income [ammunition] to the next biggest enemy, [bill] progressing to the really big ones like your mortgage. You might also just operate this plan until you have everything but your mortgage paid. If your housing cost is 25 percent or less of your gross pay you should be very comfortable and have plenty to set up your retirement years with. Lest you forget, the key is to start now. The enemy is already in your warehouse.

Save or Pay Off First?

The question always arises should I save and then pay off debt? Or just go all out on debt and then save? The first thing I recommend is to pay off credit cards and put them in a drawer and leave them alone. By paying off these first in the case of a real emergency, not a trip or a sale at your favorite store, you could use these in place of savings. It is not as good as having ready cash, but it helps offset the risk and allows you to fight the debt war with an emergency back-up. Generally the credit lines from paid off credit cards will remain available to you. After all of the credit cards or revolving debt is paid, probably cars would be the next priority. In my example below I show the student loan being paid before the SUV, because it has a lower balance, but student loans are the more flexible creditors if you get in a jam. Like most federal loans (including an FHA home loan) often you can work out a forbearance agreement or a temporary suspension of the payments if you lose a job or have health problems. Additionally you might be able to sell the cars if necessary; you can't sell your degree for cash to pay it off.

Common Sense and Principle Reduction

I have seen this basic plan under many different names for more than 25 years, the concept is not unique to me—it is pure common sense. The little extra principle payments kill off the loan. The twist is to concentrate the firepower on one bill until it is gone [dead]. Let's just call it the Debt Warfare.

Suppose you adapt this strategy having a monthly fixed burn rate [bills] totaling $3,100 that doesn't include variable costs. This is obviously a painfully simplified list. You would first list your bills from smallest monthly payment to the largest payments, as below. If you have set up Quicken as discussed in chapter 9, you have part of this already done for you. You may also simply list your bills from smallest balance to the largest as I have done below on paper. If you would like to learn about my new software to do the calculations and *what if* forecasting for you, please go to www.mrgooddebt.com. You may also download free audio from this site including an interview with a CPA about *Good Debt, Bad Debt* and this chapter. You will need to have this book in hand to answer a random computer generated two-word question from this new chapter to get a download of the software and the free audio.

List of Payments

1. Visa $78
2. MasterCard $97
3. Cable TV $120
4. Clothing Charge $140
5. Car $356
6. Student Loans $505
7. SUV $554
8. House $1,250

$3,100

In this highly contrived example, above is the amount of the monthly payments. Below are the representative balances. What is more important than the actual numbers in this example is learning the concept. I have added balances and monthly payments to help the example gain traction. Keep in mind this is not a complete budget and does not include fuel for cars, utilities, or food. This covers basic debt reduction and not all of the expenses you will commonly have.

Balances on Debt

1. Visa $1,235
2. MasterCard $1,345
3. Cable TV (monthly) $120
   ($9,292 cost over 10 years.)
4. Clothing Charge $1,456
5. Car $12,500
6. Student Loans $14,789
7. SUV $23,457
8. House $156,989

$211,771 Total Debt

Robert Manning in *Credit Card Nation* reports the average "revolver household" carries $9,200 in outstanding credit card debt. This alone is over $2,000 a year in finance charges. This figure does not include other forms of installment debt or cars or mortgages.

Here is the question. Can this imaginary, though not too unrealistic, couple get out of debt *without* an increase in income in less than 10 years, including paying off the mortgage on their house? Hint: Say yes.

Right now the best investment you can find is buying back your self-imposed consumer debt.

As we have discussed throughout *Good Debt, Bad Debt* most folks have *some* discretionary income to spend which could be used to fight debt. But there are those who would argue they have not a penny to spare, so let's cut the cable TV and just start with that extra $120; that way we have no arguments about "where" the extra $120 a month comes from. Do what the first part of the ad says, "Disable the Cable" but don't order a satellite dish. There is no magic in any of this—we are back to square one, you must spend less than you make—and save or invest the difference. Right now the best investment you can find is buying back your self-imposed consumer debt. For a refresher course on Econowise money handling, review the first five chapters of *Good Debt, Bad Debt*. This is also available (with a few ad-libs) on audio CDs or mp3s to listen to on your iPod, see gooddebt.com.

The effect of this plan is all the more remarkable if you *really* strive to put all you can into your debt elimination plan. Suppose you are leaking an extra $50 a month to fast food restaurants. Use the "what if" feature of the Mr. Gooddebt software to see how applying different amounts to your stack of debt affects the outcome. Also this is a good way to decide whether you are ahead killing off the small balances first or paying off the higher interest rate bills first. Consider adding this fast food *found* money to the cable money and see how much quicker you reach your goal.

Stubborn Fat, Stubborn Debt

Did I mention this is a lot like cutting down the calories in your diet and increasing activity? At this writing I have walked one hour a day (3.5 to 4 miles) for almost 196 days. I missed less than ten days in that time frame. I also have cut caloric intake by about 20 to 25 percent below the break-even point for my weight. The result: I lost about 33 pounds in a little over six months. Did I enjoy the exercise? I *hated* the first 101 days; I considered quitting like so many times before. Plan on the same pain and discipline on your way to success for this debt reduction plan. You will want to quit but stay the course and you will succeed.

Stop!

Did I mention not to charge anything else? Not to buy anything unnecessary? What is necessary? Things you can't live without: food, shelter, basic clothing; remember the reason you are imposing this self-discipline is because of your undisciplined past, or perhaps you are cleaning up after a divorce, sickness, or other calamity. Unnecessary spending at this point would be tyranny or at least fraternizing with the enemy.

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I'm sick of hearing it too, but the old sentiment, "When you find yourself in a hole stop digging," applies here.

Fix Bayonets!

This is hand-to-hand combat—the strength of this battle plan is to wipe out the small weaker enemy [bills] first and gain strength, ammunition, and weapons [money-cash flow] from the enemy as they are eliminated. The reason you kill off the smaller balance bills first is because the ones with the smallest balances can be eliminated the quickest freeing up all of its ammo [payment] to add to the principle of the next bill. Imagine you confront each enemy [bill] with your bayonet, gut the bill, and take his weapons and ammunition. When you meet the next bigger enemy [bill] you have more weapons and ammunition [cash flow] to overtake the bigger bill.

If gutting enemy bills with bayonets is too visceral for you, imagine yourself suffocating slowly under a never-ending pile of bills. The bills are "gutting" any chance of financial freedom for our hero in this example. If this chapter hits close to home for you, you must choose—kill or be killed. Kill them quickly with a bayonet or slowly suffer from the thousands of pinpricks they give you. Are we ready for the next mission? Beware. These missions are dangerous; a traitor lurks in the background ready to undo all of the good you have accomplished. Can you guess who it is? Right, it is you. To follow this plan requires *mere discipline*—words easy to say, harder to live.

Per plan we amass whatever extra money we have toward the Visa bill (bill number one). With the $78 we have already been paying we add the $120 from dumping cable TV. This gives us $198 (existing $78 payment and $120 from cable) toward the Visa bill, which even at 17 percent will be paid in only seven months. Of course during all of this you must pay the minimums on all of your other bills. It is easiest to fight these bills one by one, hold off the other bills with current payments, and attack in one concentrated area.

At the end of seven months we take the total of $198 monthly we now have free and buy a big screen TV, right? No! We put the whole $198 monthly plus the $97 we are already paying on bill number two, the MasterCard, and apply that each month until enemy bill number two is eliminated and we gain its strength. It's kind of like the Pac-Man® game where you get extra power for each power pill [bill] you gobble up. With each dead bill you will be stronger and stronger as you collect the ammo [cash flow] from the dead bill and march toward victory.

We now have a total of $295 a month ($120+$78+$97) to fire at this bill. At $295 a month victory over the next bill is near. The enemy is firing back at 22 percent interest but is easily overwhelmed by the strength of the $295 per month we fire at it. Even though its forces stand at $1,345 (bill number two) growing at 22 percent per annum it is totally wiped out in *five* months by the might of $295 per month.

The next bill in line is the clothing store (bill number four, number three was the disconnected cable). If we take the increased strength and ammo from the last two missions and add what we are already paying we find a total of $435 per month ($120 cable+$78 Visa+$97 MasterCard+$140 Clothing=$435) available to fight this bill with, a lot of firepower. Since the bill stands at $1,456 you can see it won't take long, in fact only about four months. War is fun when you are winning. Not only (with persistence and discipline) are you winning you are collecting the spoils of war [interest not paid] from your creditors.

War is fun when you are winning.

Sixteen Months of Discipline So Far

The American Revolution took about 8 years. The total length of our war so far is 16 months. And we have spare ammunition of $435 per month to add with the existing payment on the next bill. I hope you are still with us. Keep going, there will be deserters and some will fall prey to bill consolidators or fail by trying to pay someone else to fight their battles for them. This is a personal fight; the only way to appreciate and learn from this experience is to do the bill killing personally. You did the spending personally didn't you? Once you are down to perhaps the home mortgage and your student loan make a decision whether to switch to savings with all of the extra funds or go for debt free.

I hope you see a pattern by now—amass ammunition and weapons to eliminate the enemy. Let's move on to the next bill. The car is bill number five. This bill has more troops: 12,500 of them to be exact, much more than former foes, but we have more ammunition than 16 months ago. If we add the $435 to the $356 we are already paying we have firepower of $791. In a little less than 16 months this enemy [bill] is gone.

Higher and Higher Education

After 32 months of war we add the $791 to the $505 we are paying on student loans (bill number six) for a monthly sortie of $1,296. This defeats the debt of $14,789 at 6 percent per annum in 12 months. You'd think with $15,000 in student loans you would have learned this stuff. Aside from Professor Howard Davidoff (Esq., CPA) in his personal finance course at CUNY Brooklyn College, I am uncertain how many colleges take financial stewardship seriously. From monitoring Internet news, it seems like the trend is improving. College and perhaps high school is the perfect time to cultivate prudent financial habits. Professor Davidoff uses *Good Debt, Bad Debt* as required reading. Certainly the cost of higher education can be a good debt, but only if application of what you learn can be *sold* in the marketplace for a profit. You don't need a psychology degree to wait tables at Chili's. Back to the war . . .

> ***Certainly the cost of higher education can be a good debt, but only if application of what you learn can be* sold *in the marketplace for a profit.***

Next we add the $1,296 to the SUV payment of $554 and in 14 more months it is paid for. By applying the $1,296 and the $554 we are already paying we pay $1,850 a month for 14 months to eliminate the $23,457 loan at 6.9 percent on the SUV (bill number seven).

After 58 months war we only owe for the house. Don't weaken now—this is war! This is no time for foolish sentiments. If you are still with me, let's finish the job.

Now we can add $1,850 of ammo we have taken up from the enemy so far to the $1,250 we are already paying—that's right, we are putting the whole $3,100 a month on the house (bill number eight). Again at this point it might make more sense to save and invest the extra $1,850 a month—especially if you can earn more than the rate on your mortgage.

Remaining Home Loan:

N (number of payments)	*% Rate*	*PMT (payments)*	*PV (balance)*
247	7.5	$1,250	$156,989

Amortization with extra $1,850 per month:

N	*%*	*PMT*	*PV*
62	7.5	$3,100	$156,989

Too Much Car Lengthens the War

In 62 *more* months the house is paid for. The war is over and the good guys win. Now you have $3,100 a month coming in without obligation. Suppose you need a new car now? You can pay cash in 6 or 8 months or finance the car for 12 months or less. If at the beginning of this example you could get rid of the car at $356 a month and the SUV at $554 a month and replace them with moderate cars at $200 a month or less each you would have an extra $530 or so ammunition each month to fight debt with. It would knock 20 months off the war. Meaning in 38 months all you would owe is for the house. If you chose to drive junk perhaps with little or no payments you would be to the house-only debt in 18 months. If you are car impaired, read or listen to chapter 8. Again, I am making each chapter available for a very small cost as an audio download for those that wish to work on certain areas or give a gift to friends or family that need help in specific areas.

Gas Savers or Debt Creators?

People are often so mesmerized by cars they rarely stop and think about how financially devastating cars can be when you are heavily in debt. Knock down the car debt and you could be totally debt free in only 80 months—even the house would be paid for. With the cost of gasoline so high many rationalize the need for a fuel efficient car, and generally this is a good idea. The problem comes from not taking time to accurately count the cost of the new car. The formula for this equation is simple: You can only save the difference. If you decide to trade the old Ford to get a new Honda what is the actual difference? My Lincoln Town Car averages 19.5 mpg in town. On the road the Lincoln gets about 22 to 24 at 75 mph. The new Accord LX 4 cylinder gets 24 miles per gallon city and 34 highway according to the Honda dealer I just called. So that is about 23 percent better on fuel than my Lincoln Town Car (in town). I drive about 20,000 miles a year, mostly around Ohio. If I travel long distance, it is by air. At $3 a gallon this means about $3,077 a year in fuel cost. If I drove the Accord my fuel cost would be $2,500. If I did all freeway driving (virtually impossible) the number would be better. So doing the math I would save about $577 a year by spending $19,000 for the $21,385 Accord, plus tax, and higher insurance, and loss of earning income on the $19,000. For me a five- to eight-year-old heavily depreciated Lincoln makes a lot of sense (and they are comfortable). The hybrid Accord costs almost $10,000 more and gets just one mpg better than the 4 cylinder Accord LX in the city (it ain't easy being green).

The formula for this equation is simple: You can only save the difference.

What if you sold the house and really got a bargain on a smaller house? Many people are emotionally attached to their home. Too much house is a common problem, like too much car. In the chapters on delayed gratification and burn rate we discover only you can decide what is important to you and your family. In the house chapter I discuss right-sizing your home.

Aren't We Forgetting Something?

This is a highly contrived but possible scenario. Notice we didn't account for food and other ongoing expenses such as utilities. The payment schedule was only for actual debt. The other things that make up your burn rate would be in addition to this. You will always have to pay for food, taxes, and maintenance of the home and vehicles. Consider the concept but please don't get bogged down in these imaginary numbers. The cynics among us are already making excuses: i.e., it can't be that simple! The engineers are ready to put their numbers on a spreadsheet.

If you are concentrating on the sacrifice instead of the victory, you may consider this a quaint little anecdote but not a realistic possibility for yourself. For one thing I never mention any pay raises, bonuses, or catastrophes. Also, we are assuming you can get 10 years out of a car—oh, the humiliation! But I can do it, and many others do that or more.

What If? Here Is Your Back-up Plan

> ***Here is how you handle what if: you do the next best thing you can and then continue on your plan as soon as possible.***

Are you totally caught up in the what ifs? What if I get sick? What if the car breaks down? Suppose the hot water tank goes out? What if, what if, what if? I know a few of you want to be excused from this exercise but let me ask you this. *What if it works?* What if you live? I'd recommend living until you die, that is live fully, breathe deeply, and plan for tomorrow, which is better than worrying about tomorrow today. The time to worry about 5 or 10 years from now is today! Think about it.

The math is simple. You are the only impediment: you. Here is how you handle what if: you do the next best thing you can and then continue on your plan as soon as possible. If a car repair or hot water tank takes some money, it takes some money. We must not abandon ship at the first sign of trouble. Doing the next best thing is the contingency plan—if we fail we fail forward.

Fix the car and move on. Next month it is business as usual. I have seen some people try to operate a similar plan and when the car breaks they buy a new car, going deeper into debt and adding to the problem rather than resolving to be free from the grip of Bad Debt.

There will be times that a car is not worth fixing, but those decisions should be made very objectively. My close friend Jim Wootton has a degree in risk management so he thinks a little differently from many of us. He always makes the cost analysis before spending major money. There really are no emergencies if you pare down debt and have contingency plans. Jim tells me that the U.S. Army will repair a vehicle if the cost of repair is under or up to 60 percent of replacement. That seems bit extreme to me but there is a number somewhere in between the army's and yours that is doable. Recently his son's car, Jim's old VW, had engine trouble. The question was, do we find another car or fork out $600 for a major engine repair? $600 doesn't go too far when buying another car, unless you add a gob of debt to it, so they fixed it. That was months ago and the VW is still running fine. His son adds to his discipline of delayed gratification and his tuition for graduate school is easier to pay.

Grasp the Concept Please— Debt Warfare Works if You Do

Like most things in *Good Debt, Bad Debt* I mean to illustrate an example—your individual case certainly will vary. Embrace the light [the concept] to eliminate the darkness [the debt]. The numbers are necessary to illustrate methods, but don't get too wrapped up in them, unless you are using your own numbers. So while the cynics scoff, the Einsteins of the world would agree this plan is mathematically sound—it can work, if you do your part.

Stay on Plan on Purpose

What if you make more money than you planned? Perhaps you get a raise, a windfall, or a new job. Stay on plan, pay more, and finish sooner. Or if you are happy with your plan, begin a reserve account. In all matters of confronting debt [the past] and savings [the future] you will find sooner is better, but soonest is best. Don't give yourself a reason to fail at the beginning and quit. Consider that if you are at the beginning of a plan like this you likely have no savings anyway. Right?

Perhaps killing off the most painful things first is the best approach for many. If your age odometer is rolling up quickly and you are feeling the sting of debt, regret, and broken dreams, maybe instead of a midlife crisis you need a midlife Chrysler, or something less expensive to drive while you repair your past. Once the past is paid for you can build for the future. This concept of debt warfare is just another twist on LERI—Lower Expenses and Raise Income. Lower expenses, raise income, and do something wise with the difference.

Consumer Debt Is Not Merely Neutral—It Is Reverse Savings

Why would you want to run this plan in reverse? When you go along with minimum payments, that is exactly what you are doing. You are likely increasing the debt—the enemy takes your payment and adds equal or more in interest. If the interest does not kill you the depreciation on whatever you bought will probably leave you in a losing position. In the theater of debt warfare you are constantly attacked by both air and ground. Perhaps we could say the air attacks are the accumulation of interest charges. The ground attack is depreciation on your consumer trinkets, cars, or lost opportunities (the ultimate invisible depreciation). If you recall from the debt effects chapter, lost opportunity cost is Debt Effect Number Four.

In the theater of debt warfare you are constantly attacked by both air and ground.

If you consider each of your dollars a little dollar soldier then only those you have not sent over to the enemy can work for you. Conversely your dollar soldier's children cannot multiply to your benefit under the command of a foreign army. What do I mean by, "under command of a foreign army"? This is when the supermajority of your dollar soldiers [income] is already obligated to debt and is not producing a return for you. Consider a coup by killing off debt to regain control of your soldiers and keep them marching under your own flag.

If you are dismayed by taking 20 to 120 months to get out of debt, please remember: the 20 or 120 months will pass regardless of what you do. It's unlikely you got into your present circumstances in a few months. If you don't adapt a completely new way of thinking, you will probably go the other way, getting deeper in debt. Or as the song says, "Another day older and deeper in debt." The most successful people have a longtime perspective running 10, 20, or even 50 years. When you think and stretch your life thinking over such a long time period it underscores how insane carrying consumer debt is.

Refinance, Consolidate, or Dig In? It's the Spending, Stupid.

Truly, lowering your rate by refinancing may be a good thing but the goal is to eradicate debt not to make it a little more comfortable to live with. The comfort afforded by refinancing to lower monthly payments is often short-lived: as relief settles in, some sneak back out and run up the empty credit cards or other lines of credit available because of the refinancing. Without a true change in behavior (spending—*It's the Spending, Stupid*—would be my political campaign) you are only digging your financial grave deeper. Your burn rate or your total monthly spending as a percentage of your income is the most accurate predictor of your eventual success or failure. So where do you go after you have overspent, refinanced the overspending, and charged up any net gain from the refinancing? Some move on to questionable credit counselors. There are credible institutions out there, but do some research. Just because an institution claims to be nonprofit does not mean it has your best interest at heart. You may be better off following the plan I lay out in here. If you use the debt warfare plan and are disciplined you will come out of it having the satisfaction of defeating your bad debt yourself.