Jon Hanson

GOOD DEBT, BAD DEBT

Knowing the Difference Can Save Your Financial Life

Portfolio

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Preface

A Near-Debt Experience

It was summer 1997. I awoke lying on a hospital gurney. In the background I could hear the *beep, beep, beeeep* of a heart monitor—*my* heart monitor. I panicked. This is how it ends? Am I going to die in debt, cowering from the IRS? What will my family think? What have I been doing wrong?

I closed my eyes and hoped that it was all a bad dream. But then I remembered: I had been feeling pressure in my chest for a few days. My wife had finally persuaded me to go to the emergency room.

Still, I was fairly certain that any pain I felt was from my present financial predicament and *not* a heart attack. As I lay there alone in the ER, I realized I was cold. I was wearing one of those fashionable hospital gowns that open in the back, and I had a sheet stretched over me up to my neck: a white one, just the type a nurse would pull up over my head before telling my wife that *debt had killed her husband*.

> ***"He showed great promise early in life. Unfortunately, he expired before much could be made of it."***

I imagined that the obituary would say, "Jon Hanson (41) of Pickerington, Ohio, died Tuesday from complications stemming from lack of discipline, inability to delay gratification, and lack of discernment in financial matters. He showed great promise early in life. Unfortunately, he expired before much could be made of it."

Tell Me Where It Hurts

Dr. Gentile (his real name) walked in. He was a cheery sort. The kind of guy you really hate when you are in the middle of feeling sorry for yourself.

"We're having chest pains, Mr. Hanson?" said the doc.

"I don't know about you, but I am," I half replied, half growled.

As he scribbled something on his clipboard, I imagined that he was checking off a box next to "Sarcasm gland good." He had the look of a competent professional ready to dig for answers until he discovered my ailment or my insurance coverage ran out.

We went through family history and the usual questions. Based on the answers, Doc Gentile decided to admit me to the hospital.

"We don't know if you have had a heart attack," he said, "but with your age and family history, you are a prime candidate."

"Doc," I argued, "I really think the pain in my chest is just stress."

"It might be."

"But Doc, I owe the IRS $78,987.54!! *That's* my problem!"

"No, Mr. Hanson," Dr. Gentile calmly replied. "Your chest pains can't be from the IRS. The IRS is a stabbing, rectal pain."

I tried to laugh, and maybe I did, but it wasn't a deep laugh because I really did owe a small fortune to the IRS.

After a battery of tests, I was released late the next day. I found little comfort in being right about the source of my pain. My chest pains were diagnosed as musculoskeletal stress.

Back to Work

Actually, aside from IRS problems, I was in pretty good shape. But as far as mental comfort goes, it was like having one foot in ice water and the other in boiling oil. Then, a year or so later, I received an offer on a rental property, sold it, borrowed some more money, and paid off the IRS in full. I was exhausted from the past seven years of the "poor me" litany that had been running nonstop through my head: "It's not fair. It's just not fair. How could they do this to me? I only owed $26,000!"

There's an upside. Seven years in tax purgatory taught me a thing or two. Be they fair or not, I must deal with my problems head-on as they arise. Fair has little to do with reality. I spent $5,000 in attorney and accounting fees to stretch out the problem while looking for a way out. The result? It cost me about 30 percent more to resist. All of the books on negotiating with the IRS and paying your taxes off for pennies on the dollar are great—if you don't have any assets. After seven long years, I finally admitted my stupidity and accepted the consequences I could not avoid.

> ***The harder I looked for something to blame for my failure, the more often my own fingerprints showed up.***

After I paid the IRS, I began thinking about the internal dialog I'd had with myself in the hospital. I knew that I needed a change. With past mistakes fresh in mind, I decided to write the book I myself needed to read! Over the next four years, my research took me on an unprecedented trip through my past, my beliefs, and my poor habits. I reasoned that if success leaves clues, so should failure.

The harder I looked for something to blame for my failure, the more often my own fingerprints showed up. Most clues led to my lack of the three Ds: discipline, deferral, and discernment.

Back to the Books

Almost everything good that has happened to me came from lessons I read in a book. Certain books can confirm your path or inspire change. Books were my way out of a life of poverty. Books helped replace, repair, and improve the areas of my life where parents or teachers were not available to me. Writing is my way to help others escape or improve their lot in life. And so it is natural that I want to leave, as my legacy, a book for those I love. Many ideas I share in *Good Debt, Bad Debt* flow from my journals dating back almost thirty years. Those willing to look closely will find that financial success or failure lies in the ordinary affairs of daily life.

A few months after the September 11 terrorist attacks, I was back in the hospital for a hernia surgery and feeling rather mortal, so I decided to write a more exhaustive journal than I had been keeping. This was to be left as a guideline for my family to follow should I prematurely assume room temperature. The night before the surgery, in a rather disturbing rush of clarity, I asked myself a simple question: If I were going to die tonight, what *should I have* taught my son and daughter about life, relationships, and money? My answer became the outline for *Good Debt, Bad Debt.*

One afternoon in late 2002, I was at a local Bob Evans Restaurant editing my superjournal. I had about twenty-eight pages of a rough draft spread out on the counter. One page shouted, in its forty-eight–point boldface heading, "A Matter of Life and Debt!" A waitress, whom I now think of as Tamara the Waitress, asked if she could take a look. She read a few pages and said, "This is great! Can I take it with me?"

She seemed so enthusiastic that I decided, Why not? Over the next few weeks, whenever I would ask for my pages back, she would say, "My roommate is reading them," "My sister is reading them," "I want my dad to see them," or, finally, "I made some copies for friends. Is that OK?" This went on for a month or more and then I never saw her again. So, while my family is the reason I began to write *Good Debt, Bad Debt,* it was actually Tamara the Waitress who started me thinking that maybe I had something that other people would want to read. Thanks, Tamara, wherever you are.

Making the Rest the Best

Over the years, I have met many people who felt trapped by debt or circumstances. In short, their lives have ceased to be fun. Dragging the dead horse of debt is tiring; it is difficult to move forward while you are always paying back.

Both times that I made major career adjustments I was in very low debt mode. The first was in 1981, when I left a large grocery chain called Kroger's to start a real estate business, and the second came only recently, when I closed my real estate business to write and speak full-time. In 1981, my only desire was money, and real estate seemed to promise that. Twenty-four years later, I am still fond of money. But it is not number one on my list. Time for family and friends and a career that I am passionate about are higher priorities. I want to make the rest of my life the best of my life.

Dragging the dead horse of debt is tiring; it is difficult to move forward while you are always paying back.

As I start the second half of my life, whether I make more or less money matters little to me. I want to follow God's plan for me. I don't want to die leaving books unwritten, poems unspoken, loved ones unloved, and lives around me unchanged.

To position myself as being anti–consumer-debt is not something I take lightly. It may be fun to proclaim catchy lines like "From the guttermost to the uttermost, debt affects us all." But the awful truth is, it really does.

My passion is sharing the message of *Good Debt, Bad Debt,* whose most basic lesson is "The past is the past, unless you still owe for it." This message, for me, is absolutely foundational.

Introduction:
A Matter of Life and Debt

Never itch for anything you aren't ready to scratch for.
—Ivern Ball

It is hard to fit yourself for joy while spending money on temporary happiness. —Jon Hanson

How are you doing?
How are you *really* doing?
Are you financially fit or financially spent?
Are you scratching it up or stacking it up?
Are you living the life you imagined—or an unimaginable life?

In America we have both enjoyed and abused the privileges of our society. Yet many are experiencing an implosion of insecurity and vagueness of purpose that leaves them vulnerable to clever merchants seeking to plunder their infant wealth.

Just what are you working *for?* A quick test: Take your net worth and divide it by the number of years you have worked. What's your result? Seem lower than you thought? This number is how much you are working for per year. The rest is gone, burned up, consumed. It has gone to burn rate, which is described later in this introduction and in Chapter 3. There are other important measures of wealth, such as income, but you'll soon find that income and net worth like to hang out together. If your net worth is $100,000 and you have worked for ten years, you are effectively working for $10,000 a year, even if your actual income is $75,000 a year or more. Don't feel bad. With bad debt, some are working for room and board only; others have a negative net worth.

Certainly life is more than getting and spending money, but because money does necessarily and inescapably affect so many areas of life, it is the main focus of our attention in this book. *Good Debt, Bad Debt* is not about living a starved or pinched existence. It is about gaining perspective and right-sizing spending and saving while keeping retirement aspirations in line. It is about developing a philosophy of debt—or, for many people, a philosophy of no debt. *Good Debt, Bad Debt* encourages us to avoid the consumer entitlement mentality that can only lead to debt, regret, and broken dreams—not to mention a garage and basement full of junk.

What Good Debt *Is*

Good debt increases your net worth. Good debt helps you make money; the use of good debt adds to current earnings, net worth, or foreseeable earning ability. On the other hand, bad debt decreases your net worth. Bad debt takes your money. Payments on bad debt reduce cash flow. Compare:

GOOD DEBT

- Earns its keep
- Increases your net worth or cash flow
- Secures a discount that can be converted to cash or net worth
- Creates a leveraged position with a strong margin of safety

BAD DEBT

- Is typically for consumption
- Decreases your net worth or cash flow
- Absorbs future earnings
- Examples: car loans that rob your retirement fund; continuous credit card debt

- Examples: debt for real estate at a safely leveraged level, debt for education that can be applied for a return of capital, debt for a business you are competent to operate

What Good Debt *Isn't*

It's easy to rationalize anything we want to do with our money. Advertisers even train us to overcome our own objections! We have all done this; I have done it many times in my life. Whether your excuse is to feel better about yourself or the catch-all "I deserve it," the fact is that rationalizing debt and calling bad good does not change the reality of your financial position. Stacking bad debt on a good asset does not make it a good debt.

Stacking bad debt on a good asset does not make it a good debt.

Refinancing of personal residences has become a popular sport in America. It can be good, if done for the right reasons. The problem is that many people refinance to pull out cash or lower their payments, only to increase their debt with their new-found cash flow. For many, it only means freeing up their credit cards to be maxed out once again. Then they have all of their old credit card debt on their home and a new stack of debt beside it to contend with. Some believe that all debt on real estate is good debt. That is insane. Some lenders are willing to go 110 percent of value on real estate, so without discipline, disaster lies ahead (for both the lender and the borrower). Unless you have a real change of heart and discipline, *do not* stack credit card and consumer debt on your home equity.

If you are considering consolidation of bad debt that will encumber home equity, please read the white paper *Debt Warfare* first. Get it free at www.gooddebt.com.

Monkey See, Monkey Do?

Some Americans are beginning to question the popular notion (fomented by advertisers and popular culture) that everyone must pursue his or her own inclinations, regardless of the damage to self or society. We are seeing the result of promiscuous spending, easy credit, and, in the end, skinny or nonexistent retirement plans. Too often, debt becomes a weapon that we unwittingly turn against ourselves.

In *The Millionaire Next Door*, Thomas Stanley and William Danko discovered that average self-made millionaires save or invest 15 to 20 percent of their disposable income. In *The Overspent American*, Juliet Schor found that average Americans spend 18 percent of their disposable income on consumer debt payments while saving little or nothing. In this sad juxtaposition lies a key premise of *Good Debt, Bad Debt*: "The past is the past—unless of course you still owe for it." Many can't start up the hill of financial freedom because they are carrying a backpack full of debt.

> ***We are seeing the result of promiscuous spending. . . . Too often, debt becomes a weapon that we unwittingly turn against ourselves.***

This would be obvious if only we could step back for a moment and look at how we allocate our income. Madison Avenue and the merchants of debt heap the polite fiction "you can have it all" and "you deserve it" upon the average consumer thousands of times each day. The goal of Madison Avenue is to distract you while the merchants of debt pick your pockets.

In a recent radio broadcast Alistair Begg said, "Our society thrives on materialism, cashing in on the sin of covetousness. Its modus operandi is to create within our hearts a longing for the things we do not have. Not only a longing, but also an attitude of need and entitlement. We need it. We deserve it. Especially if someone else has it." Of course, we have free will (to a certain extent). It is up to us how we respond to messages from Madison Avenue.

Fat, Old, and Broke

Isn't it amazing, at least for a time, how resilient our bodies and our finances are? Eventually, though, poor eating and poor financial habits begin to take their toll. In the book *Good Fat Bad Fat*, Drs. William Castelli and Glen Griffin counseled readers to distinguish between types of fat that clog the arteries and those that are not harmful. In *Good Debt, Bad Debt*, I counsel readers to engage in similar discernment as to consumer debt. The statistics on obesity are eerily similar to the statistics on debt problems. The Employee Benefit Research Institute and the American Savings Education Council report that 66 percent of Americans are unable to save enough for retirement because of current financial responsibilities (debt). Peter Jennings, in a special report on *ABC News*, said that 66 percent of us are overweight. Let's hope the two groups aren't the same people. Being fat is bad enough. Being fat, old, and broke is even worse.

The buildup of cholesterol in our veins is barely noticeable until the restricted blood flow begins to cause problems. Many people go for years with cholesterol-clogged veins, never realizing the problem until it is too late. For some, a stroke or heart attack may be the first warning. For others, death is the first warning.

A similar process operates in our finances. So long as we have enough blood flow, er, cash flow to pay the bills, we don't see a problem. But in the background, too much debt, like too much cholesterol, looms as the number one killer of wealth and possibility. Once we begin to clog our financial arteries with bad debt, we may experience *shortness of opportunities* and *high debt pressure*. Unchecked, this may lead to financial death or at the least a financial infarction.

Debtabetes

In *The South Beach Diet*, Dr. Arthur Agatston writes of becoming healthy and fit through eating the right foods and balancing good carbs and bad carbs together with good fats and bad fats. In *Good Debt, Bad Debt*, I am advocating financial health and fitness through balance of good debt and bad debt. Agatston speaks of "a silent, so-called metabolic syndrome (prediabetes) found in close to half of all Americans who suffer heart attacks." I sense a similar development in many Americans' finances, perhaps a financial prediabetes syndrome. Let's call it pre-Debtabetes. Debtabetes is the inability of the body to break down and eliminate debt because of insufficient cash flow. Debtabetes is most common in the debt-obese and is closely linked to financial strokes—either fatal or temporarily debilitating. To carry the analogy a little further, we could consider spending as your glycemic (blood sugar) index and cash flow as your financial insulin. To be physically fit and financially fit requires awareness and implementation of many similar skills.

Debt Philosophy

Mr. Jim Rohn asks a great question of his audiences: "If we took your philosophy of life, and got it all down on paper, would you be excited about traveling all over the world giving talks on it?" If not, he suggests, you start there—reworking your philosophy. I labored over Mr. Rohn's challenge for months. In fact, it was the driving force behind completing this book. I ultimately wanted a book I could hand to my children and say, "Here are my core financial beliefs—they are as fundamental and as sure as gravity."

Many financial books present supplemental, not fundamental, principles. Financial failure begins in the thinking process before the actual spending. George Orwell said, "People can't write clearly because they can't think clearly." I try to avoid tortured logic and incomprehensible phrases that are the result of a confused mind. I'd expand this to finances too. **Confused thinking causes confused spending.**

After my IRS debacle, as discussed in the Preface, I realized that my primary downfall in the area of finances had been lack of discipline. While I had done pretty well overall, I felt I could have done much better. Here are three traits of my philosophy that apply to finances. To the right of them, you see the parallel yet antithetical traits advertisers and the merchants of debt want you to embrace:

ECONOWISE TRAITS:	CONSUMERATI TRAITS:
1. Discipline	1. Indifference
2. Deferral	2. Immediacy
3. Discernment	3. Ignorance
Result: *Lasting* **joy**	Result: *Temporary* **happiness**

Consumerati versus Econowise

The Consumerati are what I call those who are spendthrifts, living hand to mouth and in general never thinking of tomorrow. Consumerati are proficient at consuming at any cost. For the most part, they are well-meaning people whose ambitions far exceed their obedience to the fundamentals of money. They respond to emotional marketing appeals and, once they run out of cash, it seems only natural to use bad debt or consumer debt to pay for their wants. We all have a little Consumerati in us. According to Cardweb.com, 50 percent of Americans pay the minimum or far less than the balance due on their credit card bill. Twenty-nine percent pay off their cards monthly. Twenty-one percent of all households in America do not have credit cards. The Consumerati are likely to confuse income with wealth. They don't understand an age-old fact that spending, and not income, determines wealth. Income is like a moving river—wealth is like a lake or reservoir. See the beginning of Chapter 3 for more on this.

> ***Most men and women do not make their daily decisions based on a calm weighing of risks and benefits.***

The Econowise, on the other hand, think about how today's actions will affect their future. If we merge economy and wisdom together, we come up with the Econowise—people seeking both economy and wisdom. The Econowise plan on paper and understand how burn rate, delayed gratification (Chapter 4), and avoiding the debt effects (Chapter 1) all can work together to create a prudent lifestyle. The sooner you eliminate the waste, lower your burn rate, and begin an Econowise program, the better.

The definition of burn rate is all the money spent that does not increase your wealth. Burn rate is what is consumed and gone forever. Taxes are a major part of your burn rate, together with food, shelter, and transportation.

Give Me the Best

The last five chapters of this book are more about doing than just philosophy building. *Money Magazine* writes that recent studies by economists from New York University have found that a willingness to plan is closely linked to wealth accumulation. Before you dismiss this statement as self-evident pabulum, ask a few acquaintances how to become wealthy. Many will answer, "a large income and an inheritance." A large income is not necessarily a guarantee of wealth. Nor is an inheritance a guarantee of wealth. It can soon be frittered away. On the other hand, income of almost any size when strained through well-trained habits can create wealth.

Both Plans Are Scalable

The planning and saving habits of the Econowise scale to make them wealthy as their income increases over the years. The non-planning and debt abuse habits of the Consumerati likewise scale to make them poorer and deeper in debt as their income increases. In other words, with a Consumerati lifestyle, if you are unhappy with your life while earning $40,000 a year, you will despise it at $110,000 a year.

Life is truly asynchronous. What you do today may not have an immediate effect but may have a very large effect later in life. The whole personal finance field is pretty simple, a near mathematical certainty—until you add in one thing: human emotion. Most men and women do not make their daily decisions based on a calm weighing of risks and benefits. Most are emotional beings who respond to vague if not nonsensical messages such as "You deserve the best." Hold on! Isn't "the best" a plan that will provide you and your family with a lifestyle you've not only dreamed about, but planned for and earned? Don't seek someone else's best—seek a plan you have designed for your life, a plan that is best for you.

It's One Thing to Admit Your Stupidity—It's Another to Escape the Consequences

This is not an offering from the Self-Esteem Is Free Institute. *Good Debt, Bad Debt* is aimed at two distinct groups: those who realize that they are groping in the dark, financially speaking, and those who are doing OK but think they could do a little better. I call the blind gropers the Consumerati. They enable Madison Avenue and the merchants of debt to enjoy record earnings year after year in post-responsibility America.

To Consumerati, delayed gratification is an alien concept. Despite being part of the richest and most educated group in American history, Consumerati suffer deeply from the seeming inability to get a grip on the financial rudder. The Consumerati are, for the most part, slaves to their emotions. They are sure that they must follow their feelings to get what they deserve. The world around them seems to confirm this—they deserve the best, don't they? Consumerati men and women strive to maintain or create an image that is neither healthy nor fiscally responsible. Relax. *Good Debt, Bad Debt* will concentrate on what *you* can do *using your present income.*

My Objectives for *Good Debt, Bad Debt*

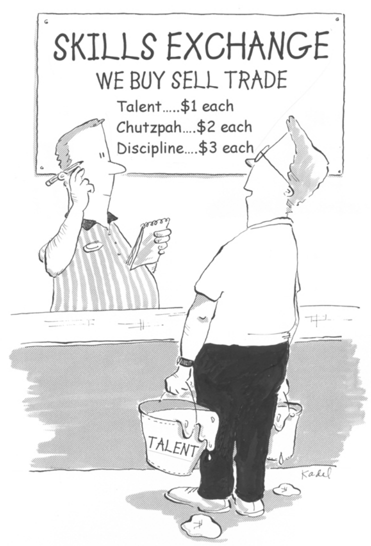
Here are my goals for *Good Debt, Bad Debt* as set out in my journal:

1. **Brevity—**To make literary bouillon cubes with a financial flavor.
2. **Wit—**Humor with its thinking cap on. Laugh or smile while learning.
3. **Visual humor—**Cartoons with a lesson of financial frugality.
4. **Incontrovertible arguments—**Arguments with results that are verifiable (knowable) in advance.
5. **Fun—**A book that's fun to write, read, and share; one that creates useful new words and terms.

Brevity. Would you buy a 763-page book called *How to Be Brief*? Mark Victor Hansen of *Chicken Soup for the Soul* fame says that most people have about two hours to spend with a book, perhaps on a short flight from Boston to Atlanta, in the evening at home, or over a couple of lunch breaks. The thinking in the book is no more important than the thinking caused by the book. See www.gooddebt.com for discussion guides.

Personal finance is simple, requiring little more than basic math and sincere forethought. We only need add human nature to finance to make it both funny and tragic.

Wit. My catchphrase for this book is "The past is the past unless, of course, you still owe for it." It seems that many people can't go where they want to go because of where they have been. Truly, what constantly pulls your past into today? Debt. If I tell a church audience, "It's hard to give your heart to Jesus when your butt belongs to MasterCard," they understand the message. Not only is it scriptural, it is common sense. When I refer to spendthrifts and those striving to keep up with their imagined reference group as the Consumerati, and people who follow a plan and seek wisdom as the Econowise, it's easy to follow. It makes sense.



I'd better trade for discipline—I haven't done too well with just talent.

Visual Humor. Throughout *Good Debt, Bad Debt* you will see original cartoons by Patty Kadel. When I developed an idea for a cartoon, I would put it in writing via e-mail or letter to Patty, who would turn my concept into a drawing. You will probably have your favorite. Here's mine—a guy dripping with talent who suffers from the inability to gain financial traction because he lacks discipline. Talent is only one part of success. If you flip to Chapter 10 ("You Married Who?"), you will see a cartoon on "relationship baggage" that generates a great deal of comment. We have all seen this type of relationship. It's a simple concept, but many overlook it or seemed surprised when the "unpacking" starts. I had a great deal of fun doing the chapter on marriage, an area in which I've done well. My wife, Nita, my son, A. C.; and my daughter, Paige, are a perpetual blessing.

Incontrovertible Arguments. Our arguments must have both texture and depth, or our success will be short lived. After the smile wears off the words, does a residue of wisdom remain? Few will argue with the saying "You must spend less than you make. You must have capital to capitalize." The first five chapters are about developing a philosophy of debt or avoidance of most debt. Except for business or investment debt (at safe loan-to-value ratios), the goal, in time, is to have everything in your personal life debt free.

> ***"It's hard to give your heart to Jesus when your butt belongs to MasterCard."***

Fun. Personal finance is simple, requiring little more than basic math and sincere forethought. We only need add human nature to finance to make it both funny and tragic. While fun is not an absolute prerequisite for success, it does make the more mundane but necessary parts of life easier to accept. If you can laugh at others' inability to embrace discipline, delayed gratification, and discernment, then perhaps you can learn these lessons without the unpleasant aspect of firsthand experience.

What's NOT in *Good Debt, Bad Debt*

No quick-fix temporary solutions. No optimistic taffy to soothe your ego. *Good Debt, Bad Debt* is about embracing the reality of where you are at and working to improve your position. You won't find specific to-do lists and forms to fill out. No slavish devotion to budgeting. When your reasons are right and you can foresee the promise of a prudent financial philosophy, you won't need someone to micromanage your life. All things will work together for good for those who embrace sound financial fundamentals. *Good Debt, Bad Debt* will concentrate on what *you* can do *using your present income.*

What's IN *Good Debt, Bad Debt*

How should you think about debt? Is debt good or bad? Can debt be an effective tool? This is a book to help you develop a philosophy of debt, spending, and saving. *Good Debt, Bad Debt* is about fundamentals—time-tested and, sadly, debtor-proven ones. It's about building a foundation for your future.

Some of it is tongue-in-cheek, but not so outlandish that people can't relate to it. For example, in Chapter 1 ("The Debt Effects"), I say, "Credit cards are the crack cocaine of the credit industry." I am not actually accusing the industry of drug pushing, just something close.

Throughout I encourage a healthy skepticism which will allow you to deconstruct advertising and media messages. Think of it this way: you edit what comes into your mind, or else the media and advertisers will. In *Good Debt, Bad Debt* I teach you to question the media and merchant messages you receive hundreds, even thousands, of times a day. When you hear the message "Don't put all of your eggs in one basket," you will wonder if the message was sponsored by the National Basket Makers Association.

> ***Think of it this way: you edit what comes into your mind, or else the media and advertisers will.***

Understand the debt effects, manage emotions, deflect media influence, work from a plan, monitor burn rate, delay gratification, track and tabulate expenses, and invest for your future. That's simple enough, right? Grasp the first four chapters and you will have a better understanding of debt and money than 90 percent of Americans. Actually put these fundamentals to work in your life as a financial liturgy, and you will finish financially ahead of 97 percent of Americans. How are you doing? How are you *really* doing?