

# Budgeting 102

## Paying Debt



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# What is considered debt?

- There are several things that are considered debt: loans, credit card balances, mortgages, accounts in collections, etc. Some debt is actively accruing interest and money is being added to your total as you're paying it down.



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**Any debt you have that is actively accruing interest should be prioritized.**



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# What is the best way to pay down debt?

- There are several methods you can use to pay down debt. The best one is going to depend on what motivates you as a person.
- If you're someone who needs to start things small at first to get going, you would find it easier to pay down your debt using the **snowball method**. If you're someone who is motivated by paying the least amount possible, you may find it easier to use the **avalanche method**. While both methods are good for most active consumer debt, these are not helpful for mortgages or most items in collections.



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# “Snowball” Method

- The “snowball” method is where you pay the minimum balance on all your debt but the smallest one and you pay any extra you have leftover toward that card. Once that card is paid off, you move to the next highest balance and continue that cycle until all your debt is paid off.
- By using this method, it’s unlikely that you will pay the least possible amount in the long run but the snowball method may still be helpful with the psychology of paying debt.



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# “Avalanche” Method

- The “avalanche” method is similar to the snowball method except you are paying the extra amount toward the debt with the highest amount of interest.
- If you’re someone who is more fearful of your balances growing larger, you may be more motivated to pay down the debt with the highest interest rate first.
- By clearing the debt with the highest amount of interest first, you are shortening the amount of time that you will have to pay debt which creates an “avalanche” effect where your extra payments will increase faster and faster to go towards the next pile of debt.



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# Mortgages

- If you want to clear your mortgage faster, you can pay half your mortgage payment bi-weekly instead of paying in full each month. By making these bi-weekly payments, you end up adding one additional payment each year.
- You should talk to your loan servicer to arrange this plan as they might be confused if they receive partial payments.
- You can also use your income tax refund or end of year bonus to make an additional payment each year.



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# Collections

- Most accounts in collections are no longer accruing interest. Unless you are trying to increase your credit score, you should always prioritize the debt that is actively accruing interest first and then clear any remaining debt.
- We expand on accounts in collections in more detail in future courses.



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# Next Steps

- 1) Review the interest rate of all the debt you are required to make monthly payments on each month.
- 2) Rank each item of debt using 1 - 100 with the highest interest rate being first.
- 3) Rank each item of debt using 1 - 100 with the smallest account balance being first.
- 4) Decide which method you will use to pay off your active debt.



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**Be sure to check out our other courses!**



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