

Financial Freedom for the Family

Lesson 2—Dealing with Debt

Introduction: Proverbs 22:7 indicates that debt enslaves the debtor to the lender. Contrary to what some teach, however, the Bible does not condemn the concepts of lending and credit. In fact, several laws regulated credit and lending among God's people Israel (Ex. 22:25-27; Lev. 25:35-37; Deut. 24:10). Credit, while not evil in itself, becomes a snare when misused and abused. Abusing credit results in sinful debt.

Key Concept: **Credit and debt are similar but *not* the same.**

- I. Important Definitions/Distinctions
 - A. Credit—"...the establishment of a mutual trust relationship between a lender and a borrower."—Larry Burkett (*Debt Free Living*)
 - B. Debt—"...a condition that exists when a loan commitment is not met."—Larry Burkett (*Debt Free Living*)
 1. Even when the loan is current, the borrower is potentially in a position of servitude. Outstanding debt always implies eventual obligation. (I'm obligated to pay when the payment is due.)
 2. When a loan payment is delinquent, the borrower has broken trust with the lender and is enslaved to his obligation.
 - C. Credit is not evil. The wrong use of something (e.g. credit) does not preclude its right use. The *abuse* of credit is *evil*. Entering into contractual agreements that you can not reasonably meet is sinful.
 - D. With few exceptions (e.g. home mortgage) credit should only be used if the borrower has the assets (net worth) to pay off the entire loan.
- II. When Credit Becomes Debt

Warning Signs of Credit Abuse

1. You don't have any savings.
2. You make minimum payments on credit cards.
3. You use credit cards for things you used to buy with cash, such as groceries.
4. You use increasing amounts of your total income to pay off debts.
5. You have more than two or three major credit cards.
6. After you pay your credit card bill, you increase your balance by the same amount or more the following month.
7. You're at or near your credit limit on your credit cards.
8. You count on the float in order to pay your bills, writing a check hoping that you'll be able to cover it by the time it clears the bank.
9. You're unsure of the total amount you owe on all your debts.
10. You take out cash advances on your credit card to pay other bills.
11. You've tried to make a purchase with your credit card and it was declined.
12. You've been denied credit.
13. You bounce checks.
14. You get calls from collectors.
15. You lie to your spouse or other family members about your spending or hide credit card statements from family members.

Key Concept: **Behavior modification (nice term for self-discipline) is the path to lifelong financial success.**

III. Stop the Abuse

A. Understand the extent of the credit card rip off.

Example: A new big-screen T.V. just in time for the Super Bowl!

1. You receive a credit card offer in the mail encouraging you to borrow \$2000 for *only* \$40.00 per month.
 2. The interest rate is a little steep—18%; but anyone can afford \$40.00 per month, right? Finally, that new T.V. you've been *needing* is within your reach!
 3. Your payment breakdown will look like this: \$30.00 per month to interest and \$10.00 per month to principal.
 4. At 18% making minimum payments, it will take over 30 years to pay off the T.V. and you will end up paying nearly \$7,000 for it!
 5. Had you invested \$40.00 per month for 30 years at a conservative 8% return, your investment would be worth around \$60,000.00.
- B. If you are abusing credit, you must stop—cold turkey.
1. Some people *must* destroy their credit cards. (Be careful about closing accounts, as that can negatively influence your credit score.)
 2. Most people can keep their cards while eliminating their use:
 - a. Put your card on ice—literally! Fill a freezer bag with water, put the card in the bag, and put it in the freezer. Having to thaw the card is a deterrent to its use.
 - b. Allow a trusted friend to hold the card for you.
 - c. Do not carry any credit cards on your person or in your car.
- C. You **MUST** establish an emergency fund.
1. The fund should have a minimum of \$1,000.00 in it.
 - a. You must first be current with all your creditors. (If too far behind, at least stay current with necessities.)
 - b. You must establish a monthly budget (upcoming lesson). A portion of every paycheck should go to the emergency fund so that it grows beyond the \$1,000 minimum.
 - c. Do whatever it takes (within confines of the law and Bible morality) to get your \$1,000.00! Sell something, work extra jobs or more hours, **WHATEVER IT TAKES!**
 2. The money should be accessible, but not too accessible.
 3. The money must only be used for real emergencies involving survival issues (e.g. car repairs, furnace replacement, etc.).
 4. The whole point of the emergency fund is to wean you off credit cards.

How much debt is too much?

DEBT TO INCOME RATIO CALCULATION	
MONTHLY DEBT PAYMENTS	
Monthly mortgage payment (include property taxes and insurance) or rent	\$
Monthly home equity line of credit or loan payment	\$
Monthly car payments	\$
Monthly revolving credit payments (furniture, appliance loans, etc.)	\$
Monthly student loan payments	\$
Monthly minimum credit card payments, times two	\$
Other monthly loan amounts	\$
Monthly child support payments	\$
Total Monthly Debt Payments	\$
MONTHLY INCOME	
Monthly net (take-home) pay	\$
Annual bonuses and overtime, divided by 12	\$
Other annual income, divided by 12	\$
Total Monthly Income	
DEBT TO INCOME RATIO	
Total Monthly Debt Payments divided by total Monthly Income = Debt to Income Ratio	%

Find your score below to rate your financial condition:

Less than 30%.....EXCELLENT

30-36%.....GOOD

37-40%.....BORDERLINE

41% or Higher.....RED FLAG—YOU NEED SERIOUS HELP!

(Note: mortgage lenders will use a different score chart in order to sell you on a larger mortgage. Don't fall for it! The percentages given above are both reasonable and realistic.)