In part 1 of this article, we talked about Good Debt and Bad Debt and explained some of the key components of Debt. In this part, we will talk about different types of debt, with a focus on the most common forms of debt, credit cards and mortgages.

**Credit Cards**

Although credit and debit cards are similar in that both can be used instead of cash for purchases, there are important differences between the two. A debit card is essentially a cash substitute and cash is immediately deducted from your bank account with no balance carried and no interest charged. Your purchases are limited by the balance of funds in your account. Debit cards are generally issued by a bank upon the opening of a savings or checking account.

A credit card, on the other hand, is a loan. Interest is charged if the full balance is not paid off each month and the interest rate is typically high, around 18-20%. Purchases are limited by the credit limit imposed by the bank. It is important to select a credit card limit that is reasonable and can be repaid in a short period. And remember, the longer it takes to pay off a credit card, the larger the total interest amount is paid.

Credit cards can be good debt if you can pay off the loan in full every month. In fact, if you pay off your credit card in full every month, not only do you pay zero interest on this debt, you can also get airline miles or other rewards.

On the other hand, if you do not pay off your credit card bill every month, then you are subject to very high interest rates and end up paying much more on this debt. Here’s an example: If you spend $200 on an item that you want, and put it on your credit card and have saved up beforehand and pay that $200 off as soon as your credit card bill arrives, you actually pay LESS THAN $200 (meaning you pay the $200 with zero interest rate, plus you get extra airline miles or reward points). However, if you only pay the minimum amount and have say a 20% interest rate and continue to pay the minimum amount, over time, that $200 item could have easily turned into a $300 or more item. So, I would highly encourage you to pay as much of your credit card off as possible and not give the credit card company any more of your money than you have to.

Of course, sometimes credit cards are needed to pay for emergencies, or for important services or items (needs versus wants). Then, this could very well be considered good debt.

If you have a lot of credit card debt, high interest rates can cause your debt to grow quickly. If you can pay more than the minimum, you will be able to repay the debt more quickly.
Remember, if you are paying high interest rates, it can be difficult for you to repay your capital. If you pay a lot of interest and only pay the minimum each month, you are in debt for a much longer time.

**Mortgages**

A mortgage is another common type of debt. It is a loan where a home or other real estate is used as collateral. Unlike credit cards, mortgages are usually “secured” debt; if payments are not made after a certain period of time, the bank has the right to seize the home and use it to help pay off the amount owed.

There are several things to consider when taking out a mortgage to help reduce the amount of total interest paid:

- Find the best possible interest rate.
- Make a larger downpayment
- Prepayments – pay your balance down ahead of schedule.

The interest rate of a mortgage is typically lower than that of a credit card because a mortgage is usually secured by the home; the home is collateral. If a borrower is unable to pay their mortgage, the bank may have the right to seize the home and then sell it to help repay the debt. On the other hand, the interest rate on credit card debt is usually much higher as credit card loans are “unsecured”, that is, if a borrower doesn’t pay back the loan, the credit card company doesn’t have something like a home to sell to repay the loan. Mortgage rates can vary, so it’s worth comparing rates and terms to find the best possible for you.

The lower the amount that you borrow, the smaller the balance that you will pay interest on. That means that at the end of the term, once the mortgage has been fully paid, the total amount of interest you will have paid will be less. Saving for a deposit as large as you are able will give you a larger downpayment, therefore the less you will need to borrow.

Most mortgages have a term of around 20-30 years or even longer. Doesn’t having debt outstanding that long make it bad debt? Well, not necessarily. Mortgages are usually considered good debt because the interest rate is usually not too high and once you’ve paid off your mortgage, you actually have something (a house for example) to show for it. And there are ways to reduce some of the interest you’re paying on your mortgage – for example, making a prepayment every now and then (make sure to specify to the bank that this prepayment is for principal and not interest, otherwise they’ll just assume you’re paying interest a month early), or saving up and placing a larger initial down-payment can make a significant impact on the total interest you pay on your loan. Both of these can reduce your overall payment.

**Education such as student loans**

Student loans are usually considered good debt, especially if these loans are towards a career or trade that will enable you to earn more money. That extra money will not only help you to pay
off the loan quickly, but it will also mean that you’ll be earning more in the future, making it worth borrowing to learn that trade.

**Vehicle loans**

This is a tricky one. If your car has broken down and you have no mode of transport and kids to get to school, it very often makes sense to take out a loan to fund the purchase of a new car, especially if the interest rate isn’t too high. BUT, if you have a perfectly usable mode of transport, often you’re better off to grit your teeth, save extra cash for a few months and either save up completely for your new car (pretty impressive feat!) or at least save for a larger down-payment, meaning that you’ll be paying less in total for the car loan.

**Overdue bills**

These are still debt. Often, you’re charged interest or a late fee if you’re late in paying your bill. Which could mean that your phone bill or electricity bill could be much higher than it needs to be. Of course, there are times when it’s difficult to pay a bill, but if you can, it’s usually a good idea to pay all bills in full.

It’s a good idea to try and keep the difference between good and bad debt in the back of your mind when making decisions on whether to take on new debt. Will this new loan further your goals and ambitions, or will it take you further away from what is truly important to you?

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