

'Good debt' versus 'bad debt'



Living completely debt-free, isn't always possible. Very few people earn enough money to pay cash for life's most important purchases like a home, car or university education. The most important consideration when buying on credit or taking out a loan is whether the debt incurred is good debt or bad debt. Let's look at two examples of each.

<p>Good debt = an investment that will grow in value or generate long-term income.</p>	<p>Bad debt = debt incurred to purchase things that quickly lose their value and don't generate long-term income.</p>
<p>Example 1: Taking out student loans to pay for tertiary education</p> <ul style="list-style-type: none"> ● Student loans usually have a very low interest rate compared to other types of debt. ● Tertiary education increases your value as an employee and raises your potential future income. 	<p>Example 1: Buying a luxury car</p> <ul style="list-style-type: none"> ● Although a car loan may be necessary if the vehicle is essential to doing business, many people buy expensive vehicles and then struggle to keep up with the monthly repayments and insurance premiums on those vehicles. ● Unlike homes, most vehicles lose value over time.
<p>Example 2: Taking out a bond to buy a home</p> <ul style="list-style-type: none"> ● Home mortgages generally have lower interest rates than other debt ● Although mortgages are long-term loans (20 years in many cases), those relatively low monthly payments allow you to keep the rest of your money free for investments and emergencies. ● The ideal situation would be that your home increases in market value over time, enough to cancel out the interest you've paid over that same period. 	<p>Example 2: Maxing out your credit card</p> <ul style="list-style-type: none"> ● Credit cards usually carry a high interest rate. If you buy a fancy R2 000 pair of shoes on your credit card, but can't pay the balance on your card for years, those shoes will eventually cost you thousands more.

The general rule to avoid bad debt is: if you can't afford it and you don't need it, don't buy it. Always speak to your financial adviser before making any financial decisions that could leave you with bad debt.



Get help understanding your retirement savings options or making a financial decision based on your personal circumstances (advice)

My Money Matters Centre

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