Please note: This is a transcription so there may be slight grammatical errors.

Debra Gates:

Debt. Almost everyone has some. Today, we're going to talk about money and discuss what types of debt should be considered bad debt and what types are actually good.

Good debt. Sounds like an oxymoron, huh? One example of good debt would be a loan used to finance something that will provide a return on your investment. Think of a home mortgage or a student loan. The longer term debt is typically viewed as good debt in part because it is helpful in creating and managing your credit score. It usually involves having collateral such as buying a home or an automobile so that if you don't make your payments, the lender can take back the collateral. Paying off this type of debt on time and on a schedule that includes interest is viewed positively by lenders and can help you become a better candidate for borrowing more in the future.

So now let's talk about bad debt. Accumulating short term debt that you cannot pay off immediately, or at least in a very short period of time, can result in what lenders consider to be bad debt because it may negatively impact your credit score and your ability to obtain longer term loans for things like a mortgage. Bad short-term debt includes things like payday loans and credit card bills that cannot be paid off in full each month. This type of debt often comes with significant fees that will increase the outstanding balance of debt you owe each month. You see, it's important to consider how interest and fees are charged on most credit cards. Do you know that over the course of a year, an outstanding credit card balance of a thousand dollars at current interest rates means that making minimum payments towards a thousand dollars balance each month will cost you about an extra $180 in a year?

Another thing that you need to understand is your credit limit, which is how much a party is willing to lend you. Credit limits can also impact your credit score. When you use up all or even most of your available credit limit at one time, that makes you a questionable risk in the eyes of creditors.

So how do you know how much debt is acceptable to carry? Well, banks believe that all of your monthly debt payments should not add up to more than 36% of your gross monthly income. This includes your mortgage or your rent, your car payments, taxes, student loans and credit card bills, plus any other debt you might owe. Ideally, you want to keep your monthly debt obligations under 20% of your gross monthly income to be considered in good shape.

So here are a few key questions to answer for yourself. How much of my pay goes to paying debts? What sort of debt do I have? Is it long-term debt where I have something to show for it? Or is it short-term credit card debt that is hurting my credit score? Can I limit my credit card use to only necessities and emergencies? Am I making every effort to pay off my debt on time and whatever possible with more than the minimum amounts?

Debt can be good or bad, and the better your ability to recognize each type of debt and how to use it, the better off you're going to be in managing your finances. Want to know more? Call CAPTRUST today. We can't pay your debt, but we can help you manage it.