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PAYING OFF DEBT IS THE FIRST STEP TO FINANCIAL FREEDOM

By Stephen N. Blaising
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The breakthrough to financial independence in 1993 may be on the debt side of your financial statement. Instead of allowing money to languish in a 3 percent savings account, why not pay off an 18 percent credit card, or pay down an 8 percent mortgage loan. After all, interest earnings are taxed; your savings on interest are not.

Today's highest yielding, safest, interest-earning investments may be where your debts live. After taxes and inflation, your traditional interest-bearing accounts - money funds, certificates of deposit, savings bonds, passbook savings - earn you next to nothing.

By applying your cash savings to your debt load, you could generate the most profitable return for years to come in the form of finance charges saved.

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Just ask Florine Lees. Our fictitious Florine has been around long enough to vividly remember the last time CDs paid a mere 3 percent. A widow and retired owner of an artificial prosthesis company, Florine bought a home in Dallas in 1977, borrowing $70,000 for 30 years at 8.75 percent.

If Lees had not been pre-paying her mortgage, she would still owe $55,000 on the home. She would make mortgage payments until the year 2007, when she will be 89 years old. Recently, she wrote me a letter:

"Whether I live here the rest of my life or sell – I'm now 75 – this is a debt that must eventually be paid by me or my surviving daughters. I'm wondering if it would be wise to pay it off now, using some money I have in annuities."

Florine is frustrated by the six percent return on her annuities. And her frustration may pale in comparison to some readers who are earning only 2.75 percent on their money market funds. That was the average seven-day yield in December. Why, Sarejevo ski lift tickets probably offer a better return on investment.

My correspondent also is concerned about the safety of her investments. When will the next insurance company fold, for example? Will her bank fail leaving uninsured portions of her deposit or even compromise the security of her safe deposit box. (And that is another story we will cover in a future issue.)

Florine's retirement fund is earning seven percent. Yes, she'd have to pay taxes on any amount she takes out of the fund, but she's going to have to pay taxes on that money sooner or later, and the longer she waits, the higher taxes are likely to be, given the new administration's desire to reduce the federal debt.

So, here's the question: Should Florine (or you) pull money from a six percent annuity and pay off debt?

When debt is a higher return

Whether or not you are in Florine's enviable position, which is what best to do with cash, don't look to traditional interest bearing accounts as the best choice on the conservative investment staircase.

Today's investment strategy is at the top of the stairs, where your debts reside. You know, up in those nose-bleed, ozone scarce altitudes of high credit rates. From my view, Florine couldn't find a better investment opportunity than her mortgage …unless she has a car loan or credit car bills with higher charges.

Despite the lowest prime rate in two decades, credit card customers still pay on average of 18.35 percent on unpaid balances. That's five or six times more than most banks pay their most loyal depositors.

As a serious aside, I also recommend avoiding the major credit cards and turning to a bank credit card, many of which can be obtained for 10 percent or less. (Arkansas restricts banks, permitting no Annual Percentage rate (A.P.R.) higher than 10 percent. For a list of national and some regional card issuers with low interest rates and/or no annual fees, call the Bankcard Holders of America, 1-800-327-7300. Ask for the Low Rate List. The price is $4, and, surprise, it is payable by MasterCard or VISA.

Since a dollar in interest charges not paid is a dollar saved with no tax burden, perhaps Florine and all of us will do well to use our year-end bonuses, our 1993 income tax refunds or our under-performing savings to pay off revolving debt.

Sure, returns on speculative investments like high-flying stocks may beat your mortgage rate, you may want to reposition your financial standing as close to the staircase landing as possible. In fact, reduce all those steps so that the door to or on the financial freedom is either in your face or bumping you in the backside.

Most of us, naturally resent stairs. But taken one step at a time, logically and conservatively, we can organize our way out of debt. With that load of stress out of the way, you can then confront the age-old question of risk-return ratios and where to invest your funds in money-making scenarios.

After all, the balance of the decade is going to be about eliminating debt, recovering economic strength and reallocating resources. That should include financial resources, too.

Stephen N. Blaising, President of Financial Dynamics, Inc. of Dallas and a University Park resident, is a private economist, financial planner and SEC-registered investment advisor.

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