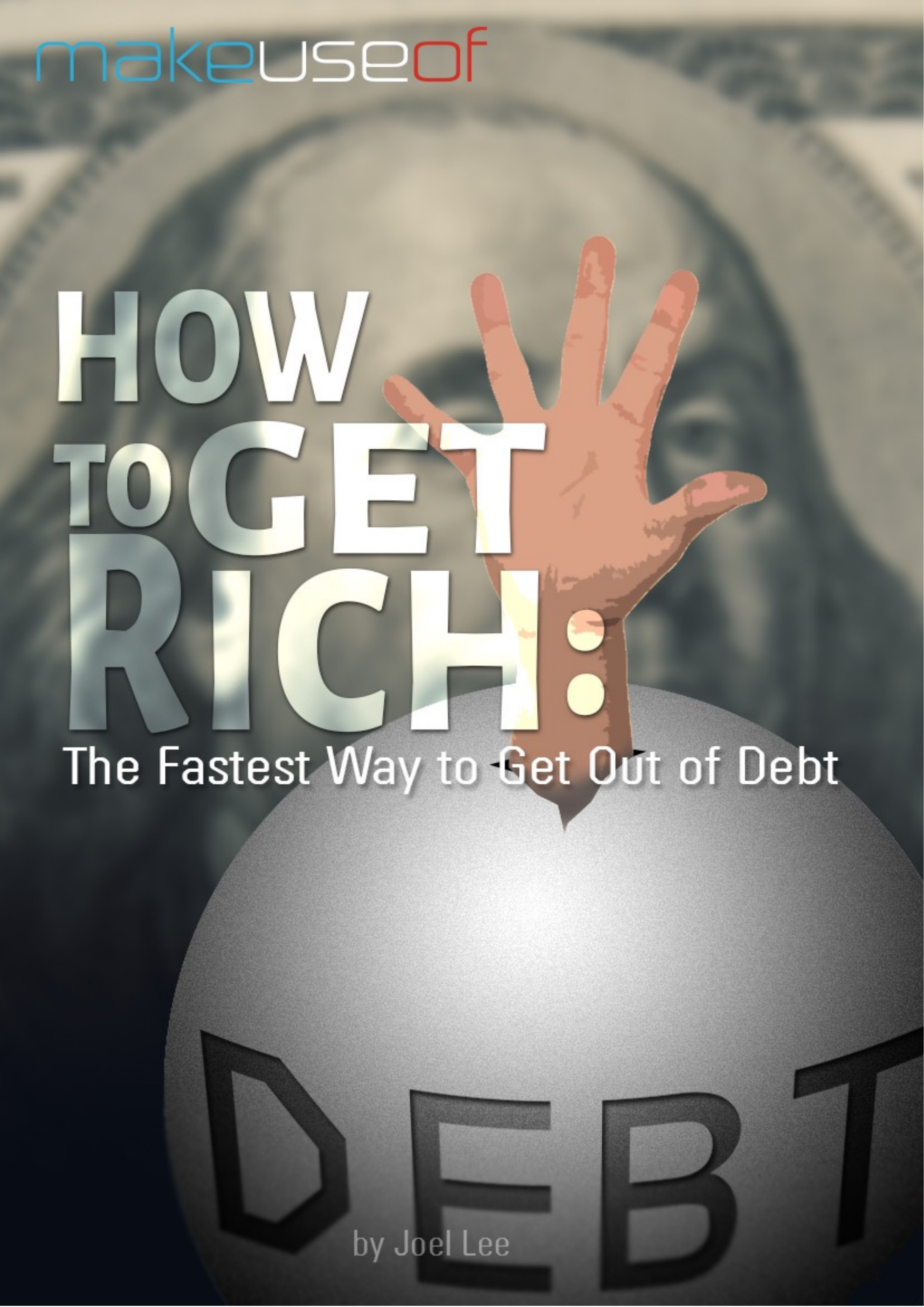
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HOW TO GET RICH:
The Fastest Way to Get Out of Debt
DEBT
by Joel Lee

# How to Get Rich: The Fastest Way to Get Out of Debt

Written by Joel Lee

Published March 2015.

*Read the original article here: http://www.makeuseof.com/tag/get-rich-fastest-way-get-debt/*



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We've all made mistakes with our money. Some of us went crazy with credit card sprees in our youth. Some of us dug our own graves with an addiction to gambling. As for me, I took out way too many student loans for a degree I'm not even using. Is there any hope for us?

Absolutely! But it won't be easy.

If you're facing a wall of debt comprised of thousands of dollars, it's time to buckle down and get serious about getting it cleared – even if it seems like an impossible task. Getting rid of that debt is a necessary step if you ever want to be rich. There's just no way around it.

# Repay Your Debts, Boost Your Happiness

Debt repayment is painful. By the time you're paying off a loan, you've already spent that money and reaped the rewards — school tuition, business capital, financing for a car, etc. — so each payment you make is twice as painful. It feels like you're losing money and getting nothing out of it.

No wonder we're so hesitant to pay our debts. Every month we're reminded that we owe money and every month we grit our teeth, send out the check, and push that debt to the back of our minds until the next month when the cycle occurs all over again.

Rinse and repeat for ten, twenty, even thirty years. That doesn't sound like a happy way to live life. Wouldn't it be great if you had no debt at all?

You'd have **more money to spend**. Each debt that disappears is like getting a raise at work. Money that was being drained into debt repayment would turn into disposable cash that you can spend elsewhere. Not only would you stop losing money, but you'd actually be gaining money.

The **peace of mind** would alone be worth it. Without that monthly nagging in the back of your mind, you'd be able to sleep easier at night. Every unloaded debt is one less bill to worry about. With more money to spend, your other bills wouldn't be as overwhelming. You'd have more money to put towards savings and investments. In essence, you'd ease a lot of financial stress.

And if you're like me, that also means **less friction in relationships**. Money is one of the most common causes for quarreling, especially in marriages with joint access to shared finances. Getting rid of debt's psychological burden can make you feel less miserable, but it can also overflow into your relationships with others and result in fewer disputes and arguments. Everyone's happier.

But most of all, it's the **greater financial freedom** that most of us want. Think of all the dreams you had to put on hold because of the money you owe. If you didn't have debt dragging you down, what would you be spending that money on? Which dreams would you finally be able to pursue? At this point, it's not just about reducing stress or increasing financial security. It's about being able to live your life to the fullest every day.

# Reducing the Amount You Owe

Before we talk about paying off your debt, it's important that we do everything we can to reduce the amount of debt as much as we can. After all, if you could take a big chunk out of your balance without even having to spend a penny, why wouldn't you? It's basically free money.

It's a lot easier said than done, of course. Every reduction in debt balance has to be paid by someone. In this case, the lender would be the one eating the loss. You can see why lenders aren't exactly enthusiastic about renegotiating debt amounts.

But it *is* possible.

*Note: We're talking about reducing the actual long-term amount that you owe to the lender, NOT reducing the minimum monthly payment. The latter is only a good idea if you're struggling to meet your minimum monthly payment as it currently stands. By reducing the minimum monthly payment, you're likely going to owe more money in the long run. We explain why that is in the section titled "The Worst Way to Pay Back Debt".*

The first thing you should do is **contact a credit counseling service**, which might be known as debt counseling in your region. Not only will a credit counselor help you to better understand your credit situation, but it also shows that you're serious about repaying your debt.

You should then **contact your lenders** and explore options to renegotiate and improve the terms of your loans. Again, lenders aren't too excited about directly reducing the debt balance, but they're usually open to waiving fees and charges that you may have accumulated. Explain your situation, convince them that you're serious about paying off what you owe, and see if they're open to reducing your interest rate and/or principal balance.


**Refinancing can be smart but risky**. In simple terms, refinancing is when you use a loan to pay off one or more other loans. Think of it like paying off a credit card with another credit card. As long as the new loan has a lower interest than the loan that's being paid off, it can be a smart move.

I repeat: **never use a high-interest loan to pay off a lower-interest loan**.

For mortgage refinancing, you can use Bank of America's Refinance Calculator which can help you see what refinancing your mortgage might look like, but it's only available in America. Bankrate's Refinance Calculator is a bit more involved but also more accurate to your situation and can be used for any kind of loan.

And remember that *you're still in debt*! You've only replaced one loan with another, and that loan still needs to be paid off. The loan balance hasn't changed; you just owe less money in the long run thanks to the lower interest rate. Don't rely on this tactic as a way to postpone your debt.

One more thing: **avoid loan consolidation**. Consolidation does not reduce the amount you owe. While consolidating multiple loans into a single loan might lower your monthly bill, you'll lose the ability to make payments into specific loans, which is a key method for paying off debt as fast as possible. We'll explore more of this in the section titled "The Best Way to Pay Back Debt".

**When is consolidation a good idea?** If the consolidated loan's interest rate is noticeably lower than the average interest rate of all the loans being consolidated, you could end up paying less in the long run.

Another reason to consolidate is when your loans have a variable interest rate. If you wait until the interest rate drops, consolidation can "lock in" a low fixed interest rate so you won't have to worry about the interest rate rising in the future.

Lastly, consolidation can relieve some stress if you're juggling too many bills from multiple loan providers. Paying one bill is certainly easier on the mind than dealing with four, five, or more individuals loans.

**Thinking about consolidation?** Bankrate's Consolidation Calculator is awesome for seeing how that might turn out for you. Input all of the loans you want to consolidate (e.g. credit card, auto, education) and it will show you what a the new loan's terms, interest rate, etc. could be and how long it would take to pay off in comparison to your old loans.

*Note: In the United States, federal loans and private loans cannot be consolidated together. This may hold true for other countries as well.*

## Where Is All of Your Money Going?

At this point, you've reduced your debt balance and/or interest rates. Or maybe you weren't able to make any reductions at all. That's completely fine. At least you gave it a shot, right? Think of debt reduction as more of a bonus than something to be expected.

Before we move onto actually paying off the debt, we need to figure out how much money we can put towards debt repayment every month. For that, we'll need to create a budget. Don't let that frighten you! Budgets are simple — even if you aren't a math whiz.


The gist of it: **Income – Expenses = Spendable Money**.

Income is any reliable source of incoming money, the most obvious being your paycheck(s). Expenses include all of your monthly bills along with anything else you regularly spend money on, including food, clothing, and entertainment. A budget is nothing more than a spreadsheet that tracks all of this in one convenient place.

Why is this important? Because it shows you where all of your money actually goes. I always thought I was spending less than $1000 every month until I started tracking my expenses. Lo and behold, all of the Starbucks drinks and impulse grocery purchases I'd make added up to hundreds of extra dollars.

Here's the hard truth: **debt is first and foremost an emotional problem**.

Most cases of debt can be traced back to a lifestyle of spending more than one can afford to spend. If you want to maintain a quality of life that your income can't support, buying on credit is the only way to make it happen. This is true whether your annual income is $30k, $100k, or $500k.

That's why a budget is non-negotiable.

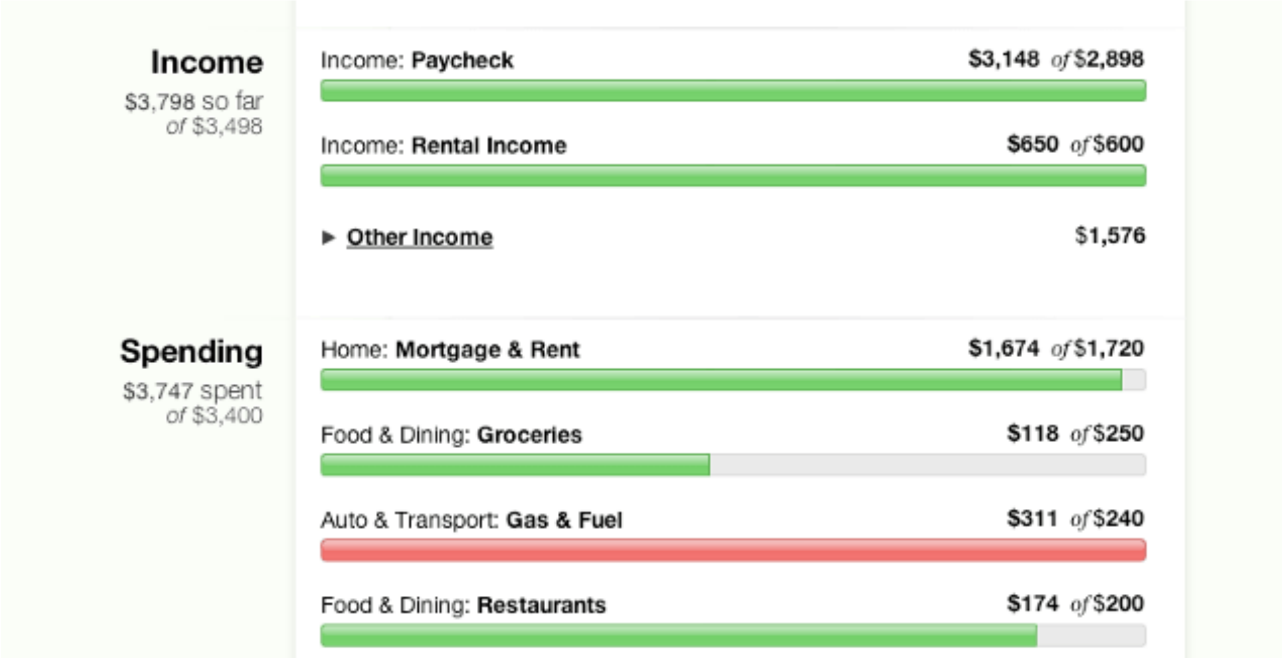
A budget shows us how much income we have available and where all of that money is going. If we're spending too much, a budget can show us where that money is going. If you spent $250 on pub drinks last month, can you bring that down to $100? Or even $0? Can you find a cheaper place to live? Can you give up name brands for generic brands? These are all ways to cut down on expenses.

For a debt-free person, it's all about finding a balance between the money that's coming in and the money that's going out. But for those of us who are in debt, finding that equilibrium isn't enough; if we want to leave debt as soon as possible, we have to take it one step further.

But we'll look into that soon enough. For now, let's talk about how to create an actual budget.

As for creating a budget, a personal Excel budget spreadsheet is simple way to create in just four steps but informative enough to serve you well if all you need is a quick tracker for income and expenses. If that's not enough for you, check out these Excel templates for finances which include several budgeting templates that can be adapted to any situation.

There are also a handful of financial mobile apps that are designed to help track your spending habits and decrease the amount you spend from month to month.




But for free, you can't beat the online budgeting tool Mint. With it, you can securely connect your bank accounts and it will automatically process all of your incoming and outgoing transactions. You can also create a budget that automatically updates with each transaction. It handles everything behind the scenes. You won't find an easier way to budget your money.

*Mint is available in the U.S. and Canada. Alternative options, like Money Dashboard, might be available in your country. If you don't mind shelling out $60 for an awesome piece of software, consider purchasing You Need A Budget — the best personal budgeting software I've seen.*

Once you've learned the budgeting mindset, you should have a sense of how much spendable money you have per month. (That's income minus expenses.) Keep this number in mind because it's going to be important in just a second.

# How Loans Work: What Is Interest?

Let's say I want to borrow $100 from you. You don't know who I am — we're strangers after all — so that's a risk you don't want to take. There's no guarantee that I'll ever pay that money back to you, right? Plus, by loaning me money, you're reducing the amount of money you have available to spend for yourself.

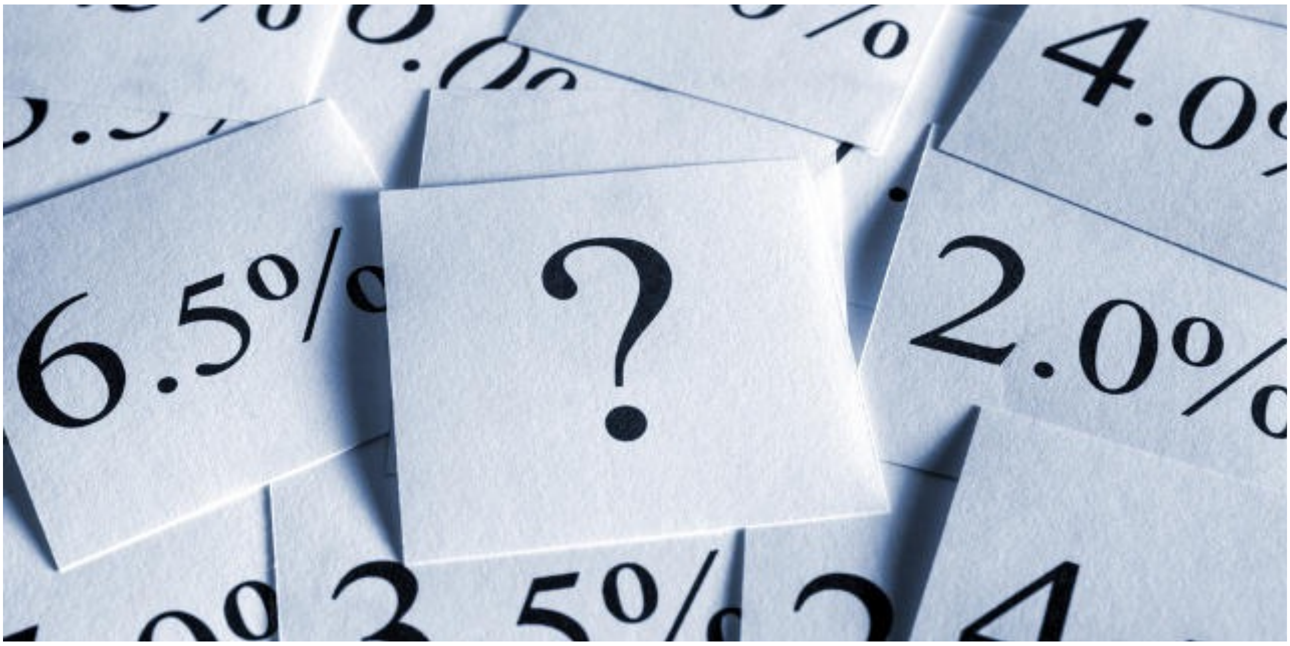
On paper, it makes no sense for you to lend me any money because it's all risk and no reward, so you decline my loan request.

Now let's say that I want to borrow $100 from you but I'll pay you back $120. Does that sound like a good deal? There's still the risk that I won't pay you back, but if I do, you'd make $20 for no effort at all. Would you lend me the money?

That extra $20 is called interest. You can think of it as a borrower's fee that offsets the risk taken on by the lender.

Let's say I have a history of borrowing money and never paying it back. Or maybe I do pay it back but I'm reluctant about it. My past lenders have had to hound me before I actually paid up. That makes me a risky borrower, so you'd only lend me money if the reward matched the risk. Maybe $20 on $100 is too little. Maybe you'd lend me that $100 if I promised to pay back $150.

Now let’s say that I have a history of always paying back my debts on time. My past lenders loved me because I proved to be of little risk for them. I’m almost guaranteed to pay you back on time, so you might be willing to lend me $100 if I promised to pay back $110. With a borrower like me, that $10 is almost like free money.



This is basically how loans work. The initial amount that’s borrowed is called the principal and the extra money on top is determined by the **interest rate**, which is a percentage of the principal. In that last example, the principal would be $100 and the interest rate would be 10%.

In the real world, there’s one little addendum: after a while, the interest that accrues is tacked on to the principal. This is called **compound interest**.


Let’s say I loaned a $100 principle from you with a 10% interest rate that compounds monthly. After one month, I owe you the $100 principal plus $10 in interest for a total of $110. If I don’t pay you in time, the interest compounds and becomes $110 principal. After another month, I’d owe you the

$110 principal plus another $11 in interest for a total of $121. If I don't pay you, this cycle repeats forever.

Knowing how loans work is important if we want to figure out the method of repayment that minimizes how much we owe in the long run.

# The Worst Way to Pay Back Debt

Every loan that you take out has a **minimum monthly payment**. Most of us are worried about keeping that minimum payment as low as possible because we need our money elsewhere.

This is a grave mistake.

If you want to pay off your debt, you must **pay off the principal**. As long as you have a principal balance, it's going to keep generating interest. By paying only the minimum, you're mostly paying for the interest generated that month. Only a small part of that monthly payment actually goes toward paying off the principal.

To illustrate, let's explore an imagined scenario that plays out in two ways: first, by only paying the minimum; second, by paying some value over the minimum.

## The Minimum Payment Scenario

Let's say you take out a $1000 loan with a 10% interest rate that compounds monthly and a minimum payment of $110.

| Month | Principal | Interest | Payment | Remaining |
|---|---|---|---|---|
| 1 | $1,000 | $100 | $110 | $990 |
| 2 | $990 | $99 | $110 | $979 |
| 3 | $979 | $97 | $110 | $966 |
| 4 | $966 | $96 | $110 | $952 |
| 5 | $952 | $95 | $110 | $937 |
| 6 | $937 | $93 | $110 | $920 |
| 7 | $920 | $92 | $110 | $902 |
| 8 | $902 | $90 | $110 | $882 |
| 9 | $882 | $88 | $110 | $860 |
| 10 | $860 | $86 | $110 | $836 |
| 11 | $836 | $83 | $110 | $809 |
| 12 | $809 | $80 | $110 | $779 |

With a $1000 loan and a monthly minimum payment of $110, you probably think the entire loan would be paid off within 8 or 9 months, right? But as the table shows, after an entire year you'd still have $779 in principal to pay off. In other words, you've paid back $1320 on the $1000 loan but only $221 of that went into paying back the principal. The rest of it was just interest.

If we kept going with this scenario, you'd end up paying an approximate total of $3150 to pay back the entire principal amount.

## The Proactive Payment Scenario

Now let's look at that same $1000 loan with a 10% interest rate that compounds monthly and a minimum payment of $110, but we're intentionally paying $200 every month.

| Month | Principal | Interest | Payment | Remaining |
|---|---|---|---|---|
| 1 | $1,000 | $100 | $200 | $900 |
| 2 | $900 | $90 | $200 | $790 |
| 3 | $790 | $79 | $200 | $669 |
| 4 | $669 | $66 | $200 | $535 |
| 5 | $535 | $53 | $200 | $388 |
| 6 | $388 | $38 | $200 | $226 |
| 7 | $226 | $22 | $200 | $48 |
| 8 | $48 | $4 | $52 | $0 |
| 9 | | | $0 | |
| 10 | | | $0 | |
| 11 | | | $0 | |
| 12 | | | $0 | |

The results are far different. The entire loan is done within 8 months after having paid a total of $1452.

Look at the remaining principal after each month in both scenarios to see how important it is to **pay off the principal**. If you only pay the minimum, most of your money is going towards paying off the interest, NOT the principal.

Repeat this until you can recite it in your sleep: **the minimum monthly payment is the most expensive way to pay back a loan**.

# The Best Way to Pay Back Debt

Now that we know the *wrong way* to pay off loans, let's explore the right way. This is where your budget comes into play. You *did* budget your money, didn't you?

Here's a quick reminder: **Income – Expenses = Spendable Money**.

Whenever possible, all debts should be paid off immediately. The longer it takes you to bring down the principal, the more you end up paying in interest. Therefore, in order to pay the least amount of interest, you should sink **as much money as you can into debt repayment every month**.

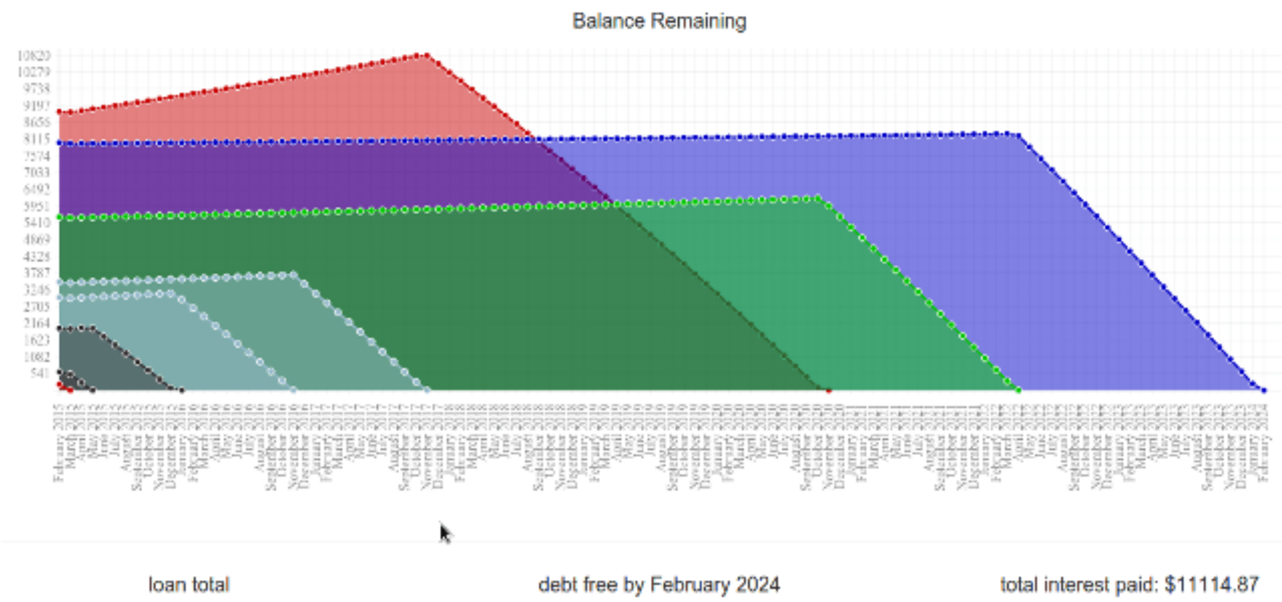
In other words, after you've taken care of your basic needs and expenses, ALL leftover money should be put toward debt repayment.

But what if you have multiple loans? Which loans should you pay off first? How do you save the most money in the long run? There are two schools of thought here.

## The Avalanche Method

In the avalanche method, your goal is to **pay off loans with the highest interest rate first**. Pay the minimum amount on every loan then sink the rest of your spendable money into the loan with highest interest. If multiple loans are tied, prioritize the one with the smallest balance.

This is the most mathematically correct approach to debt repayment. It will save you the most money in the long run.




Why is this the best method?

Instead of thinking about your debt as a handful of different loans, think of it as thousands of $1 loans. Rather than a single $1000 loan at an interest rate of 10%, think of it as a thousand $1 loans at 10% interest. Think of ALL your loans like this.

As we concluded earlier, we always want to get rid of high interest loans as fast as possible. Every dollar you put toward repayment on a high interest loan is one less dollar that's going to generate high interest down the road.

## The Snowball Method

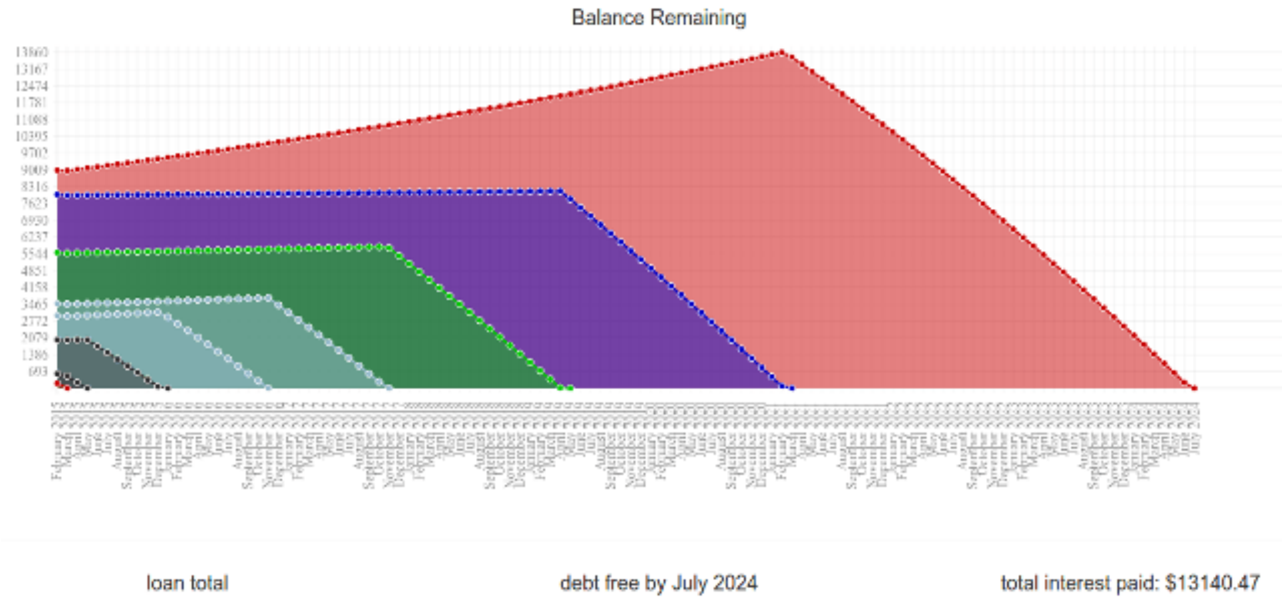
In the snowball method, your goal is to pay off loans with the lowest principal balance first. Pay the minimum amount on every loan then sink the rest of your spendable money into the loan with the lowest principal balance. If multiple loans have similar balances, prioritize the one with the highest interest rate.

This method is only slightly worse than the avalanche method in terms of absolute money saved in the long run.

Why would anyone choose this over the avalanche method?

Psychology is a huge factor when it comes to debt repayment. If you're facing a mountain of debt, it can be extremely overwhelming to the point where you might feel like you'll never pay it off. We all need short term victories to keep ourselves sane and enthusiastic, even if that means saving slightly less money in the long term.

The snowball method lets us have those victories. By targeting the lowest balance loans first, you'll be able to feel that sense of satisfaction of having paid off a loan. It feels great! It's exciting! Plus, it's one less loan on your mind. It's paid, it's done, and it's gone. The sweetness of that victory is usually a strong motivational boost to stay on track.




It's the fastest way to trim off smaller loans and leave yourself with one or two big loans by the end — and that's way easier to manage.

**Compare it now**: There's a wonderful website called unbury.us where you can input all of your loan principals and interest rates and compare between these two payment methods to see how long it'll take you to repay your loans to completion and how much interest you end up paying over all that time. You can also fiddle around with monthly payment amounts to see how that affects everything.

Two other web tools that are a little more sophisticated are Payoff.io and undebt.it. Highly recommended if you want something with a little more power and finesse than Unbury.us.

*Unbury.us was used to generate the graphs above.*

## A Side Note on "Windfall Money"

**Windfall money** is any unexpected influx of cash. It could be a bonus from work, a gift from friends or family members, or even winning the lottery. Anytime you suddenly have some extra money on hand? That's what we're talking about.

Most people use windfall money as a way to treat themselves. It's certainly tempting to do so. Maybe you want to build yourself a new computer. Maybe you feel like you deserve that brand new smartphone model that was just released. Or maybe you want to splurge on new clothes.

As much as you want that, the smarter path would be to refrain. **Dump all of that windfall money into debt repayment and don't look back**. It will save you so much money in the long run. It may seem like a waste now, but you'll reap the benefits soon enough.

Debt repayment is all about delayed gratification. You might have to suffer a bit of pain and sacrifice right now, but all of it will be worth it once you bring that final balance down to $0. Trust that you're going to love that feeling.

## The Key Is to Stay Motivated

Most of us will be stuck in debt for quite a while whether we sink every last leftover dollar into those monthly payments or not. Depending on the circumstances, you could be looking at another five, ten, or even twenty years of debt.

Knowing *how* to pay off debt won't matter if you *don't care enough* to put it into practice. You might feel enthusiastic about it all at this moment, but will you feel the same in a month's time? In a year's time? Or will you throw in the towel and revert to minimum payments?

The key to getting out of debt is staying motivated from start to finish.


**Start off with a few goals**. Of course the main goal is "to get out of debt," but it's important to set up a few short-term goals that you can accomplish along the way. Before you do that, however, it's also important that you set the right kind of goals.

A proper goal is specific, measurable, and realistic. It must have a deadline and it should be based on actions rather than results.

For example, "I want to pay off Loan A" is a bad goal because it's vague and focuses on the end result. "I want to pay off Loan A by January 2020″ is less vague but still focuses on the end result. "I will pay $300 into Loan A every month" is the kind of goal you want. It's a measurable action that you have full control over.

Long-term goals are important, too. Mint offers a Financial Goals feature that not only helps you budget your money well, but also gives you visual feedback on the progress you make. Financial Goals can include paying off debt, but can also include saving up for a house or vacation and even long-term investment goals.

**We recommend using the snowball method**. Though it'll cost you a little more money in the long run, the psychological benefits are well worth it. It gives you a set of short-term goals to achieve and ensures that you'll pay off your loans at a regular interval. It also means that you'll regularly feel the satisfaction of paying off that next loan.

Psychological boosts are your best friend and every bit of motivation helps. We mentioned Mint before and we'll recommend it again here. The various bars, charts, and graphs are great for motivation since they can visualize your progress and make it feel more concrete. If not Mint, look at You Need A Budget which is well worth the $60 price tag.

Another source of psychological boosts: gamification. Web apps like SaveUp promote better spending habits by rewarding positive financial behavior (such as depositing into a savings account).

**Celebrate every victory whether big or small**. When you reach one of your short-term goals, don't be afraid to treat yourself with a reward. Debt repayment is a marathon and it's important to take a few water breaks here and there. If you don't, you'll burn out and drown in a pool of misery.

Rewards should not cost a lot of money. We're not talking about taking an out-of-state vacation or buying a brand new television. After all, you still have other loans to pay off — unless you just paid off your very last loan, in which case feel free to celebrate big! (Just make sure you don't put yourself back into debt.)

**Find a support group or accountability buddy**. Climbing out of debt on your own is taxing on the mind and the emotions. Sometimes it helps to have a friend on the sidelines cheering you on. Or if you find that you can't keep within your budget, it's good to have a friend who can keep you in line.

## It's Paid Off: Staying Free of Debt

After a decade or two – or earlier than that if you're lucky – you'll make that final payment and breathe a sigh of relief. Your debt balance will be back to $0 and a massive burden will be lifted from your shoulders. You can live life without that constant feeling of being dragged into the mud!

**But that doesn't mean you can start living recklessly.** Diligence is more important now than ever before and you have to stay on top of your spending habits. After all, what's the point of getting out of debt if you end up falling right back into it?

You owe it to yourself to stay free of debt. You've earned it and you should do everything within your power to keep it that way.

**Stay within your budget**. A debt-free life is all about making sure that your income stays ahead of your expenses. If you want to spend more, you'll have to first boost your income. If your income drops, you'll need to rein back your spending. Easier said than done, but if you're disciplined enough to get out of debt in the first place, you'll have nothing to worry about.

**Avoid credit as much as possible**. Live by this rule of thumb: if you can't afford it on debit, you can't afford it on credit. Instant gratification is one of the easiest ways to fall into debt, especially if you're prone to impulse shopping. Want to buy that new car, TV, or gadget? Save up for it and buy it when you have enough.

There are two cases when credit is acceptable. One, when you want to become a homeowner and you're absolutely sure that the mortgage is well within your budget. Two, when building your credit score. To do this, make small purchases on a credit card and pay off the full balance at the end of every month. In any other case, avoid relying on credit!


**Invest your extra income**. For most people, the extra money that's left over after taking care of expenses is immediately spent on shiny new trinkets. If that's how you want to spend your money, go for it. That's your prerogative. However, why not use that extra money to make even more money?

Investments can be a scary topic when you're first introduced to it, but it's not very difficult at all. Depending on how risk-averse you are, there are different options available – some are high risk and high yield while others are steady and more reliable.

Learning how to invest can be as simple as tuning into these investment YouTube channels.

**Join a support group**. Strong finances require strong discipline, something that isn't very easy to maintain for long stretches of time. That's why you should join a financial support group – which is just a fancy way to say "online community" – that will help keep you on track and remind you of what you're trying to accomplish.

I highly recommend two communities on Reddit: /r/PersonalFinance and /r/Frugal. The former is all about planning and sticking to a long-term financial roadmap while the latter is all about cutting down on unnecessary expenses and living within your means. For something a bit more serious, consider joining Debtors Anonymous.

## Final Thoughts

No matter how much debt you're in, one thing will always be true: debt is not fun, debt is not easy, and debt is not to be taken lightly. You have to tackle it head-on and right now, otherwise it will keep compounding over time. However much you owe right now, you could end up paying twice as much.

Be willing to temporarily live below your standards. It won't be comfortable and you may feel like you deserve better, but the most important thing is to get out of debt as soon as possible. Once you do, your quality of life will skyrocket beyond your wildest dreams.