

## Understanding Interest on Debt

By *Scott Nash*

*“Borrowed money is had only at a price, and that price can be burdensome.”*

Scott Nash, “Understanding Interest on Debt,” *Ensign*, Sept. 1997, 64

Interest is money paid by a borrower to a lender for the use of money. When people borrow money, they pay a fee, or interest, for the privilege of using money that is not their own. In effect, debt allows the current use of future income, but that privilege often carries a heavy penalty in high interest costs.

The charging of interest has been around a long time. In biblical times, interest was called usury, which in today’s language suggests exorbitant interest rates. In 2 Kings 4:7 [2 **Kgs. 4:7**] we read, “Pay thy debt, and live,” and in Proverbs 22:7 [**Prov. 22:7**] we learn that “the borrower is servant to the lender.” The Apostle Paul instructed the Romans to “owe no man any thing” (**Rom. 13:8**), while in modern times the Savior counseled Martin Harris to “pay the debt thou hast contracted with the printer. Release thyself from bondage” (**D&C 19:35**).

Clearly scripture cautions us against incurring unnecessary debt. Modern prophets and apostles have echoed that plea (see accompanying statements on page 66). President Gordon B. Hinckley has said: “Reasonable debt for the purchase of an affordable home and perhaps for a few other necessary things is acceptable. But from where I sit, I see in a very vivid way the terrible tragedies of many who have unwisely borrowed for things they really do not need” (“I Believe,” *Ensign*, Aug. 1992, 6). To better understand the role of debt and interest charges in our lives, it may be helpful to consider what constitutes appropriate debt, why easy credit can become a trap, and how to create a personal plan to avoid debt.

### When Is Debt Appropriate?

Personal debt should generally be reserved for needs, not wants.

Borrowing money for wants could be the financial version of the “all is well in Zion” philosophy (**2 Ne. 28:21**), with people thinking that they can always pay their debts in the future “and it shall be well with us” (**2 Ne. 28:7**). “To buy on the installment plan means to mortgage your future earnings,” President J. Reuben Clark Jr. said in 1938. “If through sickness or death, or through loss of work, the earnings cease, the property bought is lost together with what has been put into it.

“I venture one suggestion, ... the ordinary family will do well to purchase by installment only the actual necessities of life, leaving the luxuries to be bought as they can be paid for when purchased.

“I shall not attempt to draw a line between necessities and luxuries, beyond saying that an artisan or mechanic who can ride to work on the train or street car would hardly be justified in buying an airplane for that purpose on the installment plan” (in Conference Report, April 1938, 105). For most persons, debt generally is a necessary obligation for purchasing a home, a vehicle for transportation, or in some cases for education.

### **The Easy-Credit Trap**

It is possible to buy almost anything today without money in hand—at least until the first payment comes due. Many companies work hard to create a mind-set in which consumers *expect* to go into debt to buy their products. Some businesses have even created their own finance companies for that purpose. Advertising for these products boldly offers “no-hassle financing” or “easy credit terms.” Some financial institutions advertise that a debt-financed vacation would relieve stress. The media constantly bombards us with the message *You can have it all today*.

An article in the *Wall Street Journal* stated that “in the mid-1990s, the temptation to plunge into debt may be greater than ever. As banks compete furiously against one another to lend, they are deluging consumers with credit-card offers” (Bernard Wysocki Jr., “Binge Buyers: Many Baby Boomers Save Little, May Run into Trouble Later On,” *Wall Street Journal*, 5 June 1995, A6). In fact, one organization estimated that credit-card companies mailed out over two *billion* credit-card solicitations in 1994 alone (see John Greenwald, “The Crunch that Stole Christmas,” *Time*, 27 Nov. 1995, 79). Some advertise “no payments until next year.” Remember that delayed payments often result in high interest costs and must all eventually be paid in full.

The ease of obtaining credit has become a significant source of temptation to some people, many of whom may eventually find themselves trapped by debt. Sometimes credit-card debt soars to thousands or tens of thousands of dollars for an individual or a family, often with little to show for it. Another problem arises when personal items that are debt-financed, such as cars, drop in value faster than the loan on them is repaid.

President Hinckley has said: “Debt can be a terrible thing. It is so easy to incur and so difficult to repay. Borrowed money is had only at a price, and that price can be burdensome” (“‘Thou Shalt Not Covet,’ ” *Ensign*, Mar. 1990, 4).

### **What Should We Do?**

President Ezra Taft Benson advised: “Now ... is the time to pay off obligations. ... Let us use the opportunity we have to speed up repayment of mortgages and to set aside provisions for education, possible periods of decreased earning power, and emergencies the future may hold” (“‘Pay Thy Debt, and Live,’ ” *Ensign*, June 1987, 5). Interest costs can be reduced dramatically by simply speeding up payments on all outstanding loans. The counsel of Church leaders to pay off debt makes good financial sense.

Sometimes people borrow the maximum possible when buying a house because interest costs can be deducted from their personal income taxes. However, keep in mind that the amount saved in taxes represents only a portion of the interest paid out. Some financial experts suggest that people would be better off with a smaller mortgage and investing the difference.

By paying extra money on the mortgage principal each month, homeowners may realize significant savings. Reducing a home mortgage provides a *guaranteed* return on the amount prepaid. Even a relatively small amount added to the monthly principal payment can produce dramatic returns. For example, payments on a 30-year home mortgage of \$100,000 at 9 percent run \$804.62 a month. If merely 10 percent, or \$80.46, is added to the mortgage payment each month, the mortgage would be paid off 9 years sooner, saving \$67,000!

The table below illustrates how much could be saved by prepaying various amounts on a 30-year \$100,000 mortgage at 9 percent interest.

<b>Prepay</b>	Total Mortgage Payments	Total Time Saved	Total Interest Savings
\$10/month	\$276,283	20 months (1.7 years)	\$13,381
\$25/month	\$260,220	47 months (3.9 years)	\$29,444
\$100/month	\$213,871	124 months (10.3 years)	\$75,793

Efforts to reduce a mortgage can be hampered by a relatively new twist to consumer spending: the home equity loan. These loans are often used to finance everyday purchases or to consolidate credit card and other consumer debts. Such decisions increase the burden of long-term debt on a family or individual and erode a home's equity.

To reduce debt, it is necessary to establish spending priorities. Our foremost financial priority is the payment of tithes and offerings. Then money for basic necessities must be budgeted. Remaining funds might be used to (1) prepay outstanding debt when possible, (2) establish a rainy-day fund to cover unexpected financial storms, (3) create a long-term savings plan for missions, educational expenses, and retirement. Savings or invested money can actually help us earn interest.

The blessings of following the advice of Church leaders by controlling debt results in greater peace of mind, financial security, independence, and comfort. Indeed, as we take responsibility for our financial well-being and live within our means, we as a people are able to “stand independent above all other creatures” (**D&C 78:14**).

### **How Well Do You Understand Interest?**

See if you know the answers to these questions:

1. How much interest must be paid on a 30-year \$100,000 loan at 9 percent interest?
  - a. \$50,000–\$100,000
  - b. \$100,000–\$150,000
  - c. more than \$150,000
  
2. On the same \$100,000 loan, how much of the principal will have been repaid after 10 years (one-third of the life of the loan)?
  - a. \$10,570
  - b. \$33,333
  - c. \$55,750
  
3. How much would a person amass by age 65 if he or she saved \$2,000 a year beginning at age 20 and was able to earn 10.3 percent (the average annual return for the U.S. Standard and Poor’s 500 Index for the past 67 years) on the cumulative savings per year?
  - a. \$95,687
  - b. \$402,037
  - c. \$1,580,475

Answers:

### What Have Our Leaders Said?

**President Gordon B. Hinckley:** “To satisfy our desires, we go into debt, dissipate our resources in the payment of high interest, and become as slaves working to pay it off. ...

“I commend to you the virtues of thrift and industry. ... It is work and thrift that make the family independent” (“ ‘Thou Shalt Not Covet,’ ” *Ensign*, Mar. 1990, 4).

**President Thomas S. Monson:** “We urge all Latter-day Saints to be prudent in their planning, to be conservative in their living, and to avoid excessive or unnecessary debt” (“To Learn, To Do, To Be,” *Ensign*, May 1992, 47).

**President James E. Faust:** “It is important to learn to distinguish between wants and needs. It takes self-discipline to avoid the ‘buy now, pay later’ philosophy and to adopt the ‘save now and buy later’ practice. ...

“Owning a home free of debt is an important goal of provident living. ... Homes that are free and clear of mortgages and liens cannot be foreclosed on.

“... Independence means ... being free of personal debt and of the interest and carrying charges required by debt the world over” (“The Responsibility for Welfare Rests with Me and My Family,” *Ensign*, May 1986, 20, 21).

**President Ezra Taft Benson:** “Our inspired leaders have always urged us to get out of debt, live within our means, and pay as we go” (“ ‘Pay Thy Debt, and Live,’ ” *Ensign*, June 1987, 3).

**President Spencer W. Kimball:** “All my life from childhood I have heard the Brethren saying, ‘Get out of debt and stay out of debt’ ” (in Conference Report, Apr. 1975, 166).

**President J. Reuben Clark Jr.:** “Interest never sleeps nor sickens nor dies; ... Once in debt, interest is your companion every minute of the day and night; you cannot shun it or slip away from it; you cannot dismiss it; it yields neither to entreaties, demands, or orders; and whenever you get in its way or cross its course or fail to meet its demands, it crushes you” (in Conference Report, Apr. 1938, 103).

**President Heber J. Grant:** “If there is any one thing that will bring peace and contentment into the human heart, and into the family, it is to live within our means. And if there is any one thing that is grinding and discouraging and disheartening, it is to have debts and obligations that one cannot meet” (*Gospel Standards*, comp. G. Homer Durham [1941], 111).

**Elder L. Tom Perry:** “We should not heed the current cries ... [that] tempt us to compete for ownership in the things of this world. ... Often these items are purchased with borrowed money, without giving any thought to providing for our future needs. ...

“... Wisely we have been counseled to avoid debt as we would avoid the plague. ...

“... A well-managed family does not pay interest—it earns it” (“ ‘If Ye Are Prepared Ye Shall Not Fear,’ ” *Ensign*, Nov. 1995, 35–36).

*Gospel topic: financial management*