Do I Sell Investments to Repay Debt?

Often, individuals ask this question: "do I sell investments to repay debt?" As with most financial matters, the answer is, "it depends on your circumstance." Let's survey briefly, borrowing, investing, and then look at specific example.

Borrowing

To get on the same page, let's define borrowing. The New Concise Oxford Dictionary, 9th edition, defines borrowing as follows:

- Acquiring temporarily with the promise or intention of returning
- Obtaining money in this way

Here is my practical money borrowing definition: You borrow money when, to use someone's services, goods, and, or money today, you commit to spend future amounts you do not hold today. So, you borrow when you use a credit card and don't pay the full balance. I want to stress (a) a credit card is a cheque and not a funding source, and (b) the best debt is no debt.

Scripture doesn't prevent borrowing, but it shows it negatively. **Proverbs 22:7** says, "The rich rule over the poor, and the borrower becomes the lender's slave." But it's clear that when you borrow you should repay **(Psalm 37:21)**; bankruptcy isn't an option! Apostle Paul re-enforces this message in **Romans 13:8:** "owe nothing to anyone except to love one another; for he who loves his neighbor has fulfilled the law." Besides reminding us to pay our debts when due, Apostle Paul reminds us of our debt to love one another.

Investing

Investing is merely another spending form. Like all spending, we must go to the Lord and understand His best and our motives. Before investing, first understand differences between, saving, investing, speculating and gambling. These are the Concise Oxford Dictionary's definitions:

- **Save:** Reserve, keep for future use, refrain from spending
- **Invest:** Apply or use for profit
- **Speculate:** Invest in stocks etc., in the hope of gain but with the possibility of loss

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•**Gamble:** Take great risks in the hope of substantial gain, a risky undertaking or attempt

Note; invest, speculate and gamble include risks to different degrees. Savings do not. Don't invest, speculate, or gamble with God's money.

Investments can be safe, low risk with modest returns, or unsafe, risky, with possibly high returns. It depends on your goals and motives. Investing is about your Attitudes, Behaviours & Choices (ABCs), so learn "right attitudes" for investing. Stay close to the Lord, obey His commands, and remember:

- Investing is about the future that only God knows.
- The first and highest yielding investment is to store treasures in heaven.

Paying off Debt versus Investing or Maintaing Investments

This decision has two parts: Numbers and emotions—both can be significant. Do the "sleep test"! Ask, will the decision cause loss of sleep?

Let's look at the numbers. First, distinguish "registered" from "non-registered" investments—the difference is the tax treatment. In Canada, you can withdraw Registered Retirement Savings Plan investments (RRSP) anytime and pay taxes at your marginal or highest tax rate. Financial institutions "withhold" an amount from withdrawals—this is the withholding tax, which is temporary. So, before withdrawing RRSP investments, estimate current year's taxes to get your highest or marginal tax rate for that year—that's the relevant tax rate. **It's essential for withdrawals,** to distinguish "withholding taxes" from final taxes—the relevant tax you calculate in your tax return.

If you are deciding between keeping investments such as RRSPs, or repaying your mortgage, look at mortgage rate, which, in Canada, **is after tax,** compared with RRSP income, which are **before taxes.** If you decide to repay mortgage or other loans, what will you do with prior monthly mortgage and loan payments? Note, normally, without specific attention ,expenses rise with income. Next, are you and your spouse on the same page with this?

Run the numbers, ask the Lord for wisdom, and before you decide, look at the full effects on your lifestyle, and your relationships.

In summary, I suggest, subject to individual circumstance, and the Lord's guidance, (1) repay all non mortgage debts, (2) start a Capital Fund (pages 196 to 203 of The New Managing God's Money-The Basics) to handle capital items and emergencies, (3) repay mortgage (4) start investing. If your employer matches pension or savings, take advantage of this after you start your Capital Fund. For more on this topic, see The New Managing God's Money-The Basics, chapters 5-6.

Let's look at a disguised, real life situation at 31 December. We will call this couple Patrice & Lucy and assume their marginal tax rate[iii] is 40%.

Things of Value (Assets) at Market Value - C$

Primary Home (cost $ 130,000)		150,000	
Car		7,500	
Furniture & Personal Effects		25,000	
Savings		2,000	@ 1.65%
Bank Accounts		100	
	Total	**184,600**	

How Things Of Value Are Financed - C$

Mortgage from Bank		120,000	@ 6.5% -3 years closed
Car Loan		10,000	@ 8.5%
Department Stores' Credit Cards		9,350	@ 28.5%
Visa		6,000	@ 19.5 %
Credit Line (limit of $ 7000)		7,000	@ 7%
	Total Loans	**152,350**	
	Own Equity	32,250	
	Total	**184,600**	

Their combined income is $5250 per month and their monthly mortgage is $844. They pay the minimum monthly amount on each credit card, but insist on saving a small amount monthly: Lucy and Patrice believe it is important to have a nest egg.

Identifying the Source of Value

The critical factor for Lucy and Patrice to grasp is that they make interest and loan payments from after tax income. To pay $100 they must first earn $ 167[iv] and pay tax of $ 67 (40% of 167). Thus, to pay interest of $222 (28.5% of $9350) per month on their department stores' credit card balance, they must first earn $370 (222/60%) and pay tax of $148 (40% of 370). In other words, the pre tax interest cost of these cards for one month is $ 370 (9350 X47.5%/12)!

On the other hand, the savings rate of 1.65% is pre tax. If they deposit $370 in their savings account, it will earn about 50 cents per month (370 x 1.65%/12). However, if they used $ 370 to reduce the balance of their department store debt, they will save $ 15 per month (370 x 47.5%/12) before tax. Their best strategy, therefore, is to repay their loans, starting with the most expensive and ending with the least expensive.

Here is Lucy and Patrice's ranking of the cost of their loans, and interest on their savings opportunity:

Loans/ Saving Opportunity	C$	Pre tax %	Annual Savings from Repaying/ Saving $ 1000	Rank for Payment
Department Stores' Credit Cards	9,350	28.5%/.6 = **47.5%**	**475**	1
Visa	6,000	19.5% /.6 = **32.5%**	**325**	2
Car Loan	10,000	8.5% /.6 = **14.2%**	**142**	3
Credit Line	7,000	7%/.6 = **11.7%**	**117**	4
Mortgage	120,000	6.5%/.6 = **10.8%**	**108**	5
Savings	2,000	1.75% = **1.75%**	**18**	6

The best financial return to Lucy and Patrice is to repay their department stores' credit card balance[v]: They should immediately use their $ 2000 savings to reduce that balance. This will **save immediately $ 79** per month pre tax (2000 X 47.5%/12). If they left this amount in their savings account they would **earn $2.75 per month.**

The principle to apply, therefore, is to **view loans and savings as similar**. Compare the pre-tax cost/return of each and apply funds to the highest pretax percentage item. **The sooner you repay expensive debt the sooner you will be able to start to save. The longer you wait to repay your debt, the longer it will take to accumulate savings.**

If your loan is tax deductible, use the nominal rate (the rate specified by the institution), such as 28.5% for department store credit card shown above, as the relevant rate for your ranking.

Once you have repaid all loans, including mortgage, if you are paying taxes, **maximize RRSP contribution**: the higher your tax rate the greater your potential RRSP return! Imagine you had no loans and you decided to apply to savings, the amounts you pay currently to service loans - and the income was sheltered in an RRSP account! The **tax benefit alone, would be significant savings! Remember, RRSP deductions merely defers taxes.**

Ignore those mutual fund sales persons who tell you to borrow to save! There is risk associated with financial leverage! Don't go there! In our debt-counseling sessions, Doreen and I have seen too many individuals in debt, who were advised to take another loan to save! I think you will agree from the table above that this is a bad strategy, particularly for someone already in debt!

Patrice and Lucy have decided not to start "saving" until they extinguish their loans. They have developed goals and prepared a plan to be debt free in five years. They have committed to review their performance weekly to ensure they remain on track.

Finally, in my view, the first and essential step to get out of debt is to get your spiritual life in order.

Though Patrice and Lucy are developing new "Attitudes" toward money, they have decided not to increase their "low cost" Credit Line debt to repay higher-cost debt; if they did, they fear they will not reduce total borrowing because of the current temptations to spend.