

Got Extra Cash? Better to Pay Down Debt, or Save it?

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Money Tree at FOXBusiness.com

Got some extra cash and getting ready to sock it at paying down some debt? Well, the experts caution, not so fast.

“It’s a good idea to have both savings built up and pay off debt, but it’s not wise to put all your extra cash into debt, you need to have extra cash on hand, particularly in this unstable economy,” said Henry Baum, personal finance expert at online coupon site Savings.com.

Prioritize

Don't make a common mistake of missing the fine print when it comes to which debt is costing you the most. Bigger-balance-due doesn't always equal higher-interest-rate.

“When people start to pay down accumulating debt, they tend not to be strategic about it,” said Tom Petro, author of **"Save! America: Your Guide To Financial Freedom"** and CEO of Fox Chase Bank. “They target the biggest debt bet, but that isn’t the best idea.”

Baum suggests tackling credit cards with the highest interest rates and paying the balance off first, because they will cost you the most in the long run.

“Pay at least \$100 more than the minimum, that should put a dent into the bill but allow some breathing room.”

House vs. Other Expenses

And using extra cash to pay down the mortgage quicker also isn’t always the best idea, according to the experts. Mortgages tend to be low interest and tax-deductible debt, while other credit accounts typically are not, and can therefore snowball on you.

But when it comes to paying down your mortgage or investing in a mutual fund—your home is the better bet, Petro said.

“If you have \$10,000, you are better off paying down your mortgage, because when you do that even if you just refinanced recently and you have a 5% interest rate, you would have to get an after-tax return of at least 5% in a mutual fund, and that is very hard to do,” said Petro.

Create a Cash Reserve

Today, every household should have a cash stash that could, if necessary, cover at least six months of living expenses, according to Kay.

“We are in a slowdown and 78% of Americans have some form of credit scarring, the 800 credit score doesn’t exist anymore, you can't use the credit card to live on like you did in the past to deal with unforeseen expenses.”

Face the Math

Spending increases with the more you make, according to Petro.

“But unless you have a written plan, you won’t stick to any sort of budget ... and then you are just winging and you keep spending rather than getting under control.”

He suggests paying yourself a cash allowance each week, and practicing discipline: Once it’s gone, it’s gone.

“That brings an incredible control to someone trying to regain financial normality.”