Debt, Coke and Sausage Rolls

Hey guys. It's Dymphna here. What I want to do this morning is actually talk about paying off all that unwanted credit card debt, store card debt and even our home loans.

All of these mortgages and loans, they're not tax deductible and the minimum monthly payments that they ask us to make, all they do is keep us in the never-never plan of poverty basically because we never seemed to be able to stick our head above the water. It's all very easy to go out there and get credit cards and store cards and just whack another increase on our mortgage to go and buy a luxury item like a trip overseas or maybe the new car, or whatever else. But the fact is, it's one big trap. So what I want to talk about now is how you can actually implement some amazing strategies which are really quite simple and easy to do and really get in and pay off those unwanted and non-tax-deductible debts, I mean that's the main thing. You can't actually claim the interests on these mortgages or loans as a tax deduction because you haven't put them to anything of any good use. They haven't gone towards anything that's actually producing an income because if you had, then of course, it would be tax deductible.

So let's have a look at that. Now, the first strategy that I want to talk to you about is a strategy that I have taught for years and years. It actually started when I was in my accountancy practice and I call it the 'can-of-Coke-and-a-sausage roll' strategy and it came about because I had a client who was a courier and every morning he'd get up really early and he used to deliver bread. He used to get up really early in the morning like 4 o'clock in the morning and he start his delivery and by the time he'd got to around about 7/7:30am he always ended up at this one particular take-away store. He used to deliver the bread to them and over the years he made this habit and when he got to this particular store, he'd have a can of coke and a sausage roll and it got to a stage where really the shop keeper would have this can of coke and sausage roll waiting for him at 7/7:30 in the morning. I mean I can't of anything more ridiculous actually having a can of Coke and a sausage roll of that hour of the morning but anyway that's what he used to do.

He came to me because he was having trouble saving; he had credit card debts, he had a home loan and he really wanted to get out there buy positive cash flow properties. He had heard me speak a number of times and he just couldn't seem to get his head above water. He just couldn't seem to save enough, to get into the property market.

So he came to me in sheer desperation and said, "What do I do?" He said, "I just want to get into the property market. I don't seem to be able to get ahead. I don't know where I'm going wrong. What can I do?" So the first thing I asked him to do is what I do and ask anybody to do when they've got things that are little bit out of whack.

Now, I don't care whether it's your weight that's out of whack or your money that's out of whack or anything. When something is not working for you, the first thing you need to do is track it and what I asked him to do is actually track everything that he spent for a whole month - I call it a money tracker. I didn't want him to change any of his habits. I didn't want him to do anything differently at all; all I wanted was for him to write down everything that he spent. Everything from take-away pizza to chewing gum to vegetables from the shop. I wanted to find out absolutely everything he spent his money on for a whole month and not change anything. He was very diligent. He came back to me in a month's time and he had written out all of these columns and spreadsheets and everything of where he spent his money and I said to him, "Okay, now let's down with this list and go through what is essential." So we'll take all things that you need for basic living and, there were things like health insurance and he has his normal grocery bill each week and things like that - fuel for his van and all that sort of stuff.

So, I went on through the list of the things that he felt were essential. We had it all and we put them to the side and then we added all the things that we thought were optional and they were the take-away pizzas and things that he could have changed and bought something more economically that what he was doing, so it's kind of like wasteful kind of things that he was spending money, so we had all those and put them to another side. Then we looked the rest and pretty much the rest of them were luxury items. We sort of said, "Okay, well if you really want to get out there and buy positive cash flow property, are you prepared to give up these things?" And of course, the answer was, "Yes, absolutely. That's what I'm here for. I want to buy positive cash flow property and I want to start investing and I want to start changing my life so that I can maybe not be a courier in the future." So I said, "Alright." Well, the first thing is, "No more of these. They're on the bad list." So, I wrote all of those out and they went up in his van as not having any of these for the next three months. So I put him on a three-month money diet effectively and then all the optional things, what we did was wrote down all the things that perhaps he could have made better choices for.

So instead of eating out three times a week, it was like, "Okay, well let's buy vegetables and let's buy groceries and we'll eat more healthily and all that sort of stuff." And one of the things that was on this list was this can of Coke and a sausage roll and he said, "Oh no, there's no way. I can't do it without my can of Coke and a sausage roll. Absolutely no way. That something that's just saves me, I can't do without that. " So, we argued about that a little bit and then I started to show him some figures and when I started to show him what $30, which is what he ended up spending in a week - the can of Coke, and the sausage roll - when you added up a whole week everyday that he's at work six days a week, it came to about $30 a week and I started to say to him but $30 a week is a lot of money. You start to compound that over a year and you start to realise that it's a lot of money that could be better employed, for starters getting rid to some of these credit cards that he had. Eventually after some arguing, he agreed and that he would make better choices with his can of Coke and sausage roll and he would actually use some of his grocery money that he had allocated at the top to make some lunches and bring that along for his breakfast. I did point out the fact that he was perhaps a little on the chubby side and maybe no can of Coke and sausage roll might actually do his health a bit of good as well. So he agreed to do that and that was all fabulous.

Two months went by and I said that I wanted to check in with him after a month and then another month and then we'll do a rehash completely in three months' time and he was pretty good.

When he came back in a month's time, he bounced through the door and he came in and he was looking a heap better and he was feeling better and all sorts of things and he had saved this $30 a week and then I started to talk to him that how that can be started to apply to his credit cards and just how quickly they could be paid off, if he just put this can of Coke on a sausage roll money through to his credit cards and start to pay them down. Well, his story is remarkable really because within 12 months, he was actually into his first positive cash flow deal. It's only a small one but it got him going and really started to make headway, so we cleared out the credit debts first using a strategy that I called the 'avalanche strategy'.

I'm going to teach you that this morning as to exactly how you do that. You analysed all of your debts and which one you choose to pay off first but the first thing I'd like to do is actually step you through a scenario of paying off a $250,000 loan.

I must tell you something, I've spoken in a number of different countries around the world and America was one of them and I remember talking about this strategy years ago of this can of Coke and sausage roll and how you can reorganise your expenditure by choice to re-allocated to something that's going to serve you better like paying debts and put towards positive cash flow properties and those sort of things. And I remember looking at the audience and they were just looking at me with this really glazed look on their face and in looking at their face, I thought, "These guys don't know what I am talking about." And then I stopped and I said to them, "Do you guys know what a sausage roll is?" And they're going, "Na, what's a sausage roll?" And I was like, "Oh my God! I've been rabbiting on here for the last 15 minutes and they have no idea what I was talking about." I said, "Okay, we'll just substitute the word hotdog." Because if you substitute the word hotdog, it all makes sense like, "Ahh okay." So then I have to explain what a sausage roll actually was and they're going, "Eww, you eat that!?" It was very very funny.

But anyway, let me get back to the story of actually looking at a $250,000 loan and this is true story. It was actually a nurse who was student of mine and she worked to a debt-reduction plan that I laid out for her and she wanted to pay off this $250,000 which was the last amount on her home loan and her interest rate was 7.73%. She had a 30-year mortgage and when you do the numbers on that, it comes out in at about $1,800 per month re-payment, $1,807 to be precise. Now, you do the numbers on that. When you work that out of over 30 years, she actually ends up paying $394,000 in interest on a $250,000 loan. So she actually ends up paying more than the amount borrowed in interest over the 30 years. So, she pays up for 250,000 and a further $394,613 in interest over that 30-year period. Isn't that astounding?

I really encourage you guys to get out there and work out how much interest you're going to pay on your loans that you've got now on your houses over the term of the loan. It will absolutely rock your socks off. On top of that, when we add on the bank fees that she was paying every year, that came to a further $7,200, so it's like, "Wow!" She's paying more than the amount she borrowed over that period of time to pay it back, just an interest plus the amount she borrowed. No wonder the banks are making whatever they're making in profits. Anyway, what I asked her to do was to pay her mortgage re-payments more frequently. I didn't ask to pay any more, just pay her mortgage re-payments more frequently because when you take out a 30-year loan, what they do is they automatically put you on a monthly payment plan and it's actually quite difficult for budgeting and things like that to make sure you got that money at the end of the month or the middle of the month or whenever you payment is due to meet that re-payment. So, paying it more frequently actually makes a lot of sense.

In her case, I asked her to pay it every two weeks. Now, the reason I did that was simply because her particular bank didn't allow her to pay it weekly. If she was allowed to pay it weekly, I would say, "Hey, pay it weekly." You actually be astounded and just how quickly the principal starts to come down once you start paying it more frequently because less is being charged in interest. You see when you pay it monthly, the bank charges you a month's worth of interest whereas when you're paying it more frequently, let's say two weekly, then they're only charging you interest on two weeks for half the payment and then a month, for the other half of the payment. So at least for half of the amount, you're only being charged half of the re-payment for that month. If you pay it weekly which is obviously better and the only reason she didn't do that was because as I said, her bank didn't let her. Then on the first quarter of the payment, if it's four weeks in the month, the first quarter, you're only being charged one week of interest and then the second payment, it's only two weeks of interest and then the third payment, only three weeks of interest on that one quarter and it's only the last one that you make in that month that you're being charged for a month's interest in. I know that doesn't sound like a lot but I tell you now, it so is. It just makes such a dramatic difference.

Let me go back to my nurse's story. In her case on her $250,000 loan, simply by paying her repayments every 2 weeks at the same interest that that she wasn't paying anymore over the year, she cut her interest bill from $394,613 over paying it monthly down to $281,340, now that's a saving of a $115,000 over the term of the loan and yet, that doesn't hurt anybody, just paying your re-payments more frequently, it doesn't hurt anybody. It just saves you so much money and people think about retirement and things like that, you know, people don't have much retirement anymore or this kind of thing. It's because of this, it's because of bad money management skills. Simply paying things more frequently, anybody paying off their house would have on this $250,000 that's how much they paid off would have an extra $115,000 at the end of their payment to pay off that loan and that's investments that produce them partly an income anyway to get out there and earn some money. Just these simple little tools makes such a dramatic difference, so by paying it fortnightly, in her particular case, it not only saved her a $115,000, it also took 7 years of the term of her loan, imagine that. So, she pays off 7 years earlier and she saves $115,000 and it hasn't cost her any more money. She has just been sensible with the way that she's managing that money.

Now, the next thing I told her to do is okay, let's consider this 'can-of-Coke-and-sausage-roll strategy'. I related it back to my courier client and what he had actually done and I said to her, "Look that accounts for like, $30 a week." So we went through her scenario and did the same kind of exercise with the money tracker and whatever and her thing was not a can of Coke and a sausage roll, it was the latte. A latte here and there and whatever else, so she decided that that was something that she was quite happy to make a decision on to change around and put that money to a better good. Now, I know some of you smoke and I'm the worst in that regard because I'm very against smoking but I know it's hard to give up and all that kind of stuff but the money that people are paying on cigarette is horrendous and just putting that money towards these loans just makes such a dramatic difference.

If you could just see the figures of what that actually means to you. It might be the occasional drink here and there. It might be something else like late fees - this is my biggest problem. My jolly children - like late fees on videos and you pay for the thing three times before you end up talking the video back. That's my weakness, I'm afraid. So all of those little things, you look at all that kind of stuff and you go, "Okay, well I'll be more stringent on those things and we'll put that towards the mortgage."

So in my nurse's case, I said, "Okay, there was the lattes, so they added up to about to $30 a week as well." So I said, "Let's put that money instead of on the lattes, let's put it onto the re-payment on the loan." Now because she was paying fortnightly, every two weeks, that meant that it was actually $60 extra that she was paying on her re-payment. It was $30 a week but $60 every fortnight. So just doing that, what that did is it took some more years of the term of her loan and her 30-year mortgage now reduced to 19 years and 3 months and she had total saving in interest of a $165,000.

Isn't that astounding when we start to add up all these things just what a difference it actually makes. So the next thing I said is, "Okay, we've done that. We're doing really well on it. Let's do a little bit more." Now this is a strategy that was probably implemented into Australia 20 odd years ago, I supposed and when this type of banking product came out and it became popular, people used to charge anywhere between $4,000 and $14,000 to set this up for you. Now that's just really ridiculous because you can do it, free yourself. This is ridiculous to be paying anybody to do this for you. And what it is, is the way of utilising your money flow and because and my nurse was on the salary of $60,000, what I said to is, "Okay, setup some type of either line of credit or redraw facility or offset account where you salary goes into that offset account." And as soon as the money comes in from your employer pop up in into this offset account and every day that it sits there, it's working on paying down your mortgage because if you have a hundred percent offset account and the same applies to the line of credit but let's say it's an offset account. If you put that into an offset account beside your loan, for every dollar that you have in your offset account, you don't get charged interest on that dollar on your loan. It's absolutely brilliant. So what that means is, that she can put her $60,000 into her offset account and then I said to her, "Instead of making your payments and doing your living and all of that kind of stuff add of your offset account for the month, what I want you to do is go and get a 55-day low-fee credit card. Now, it's to be used very strictly, this is not something for you to get out there and go and spend more money on goods and services and whatever you want to spend the money on, you know, luxury items, that's not what it's about.

This is just to cover your normal expenditures that you would spend money on any way as we saw from the money tracker that we did and we pay for that on this low-interest 55-day interest-free credit card because that's what the most of them, 55 days. So that's what she did, so she started to when she would go to the grocery, she'd used a special 55-day interest-free credit card and she would pay for the groceries and pay all her normal expenses and whatever else.

Meanwhile, what's happening over those 55 days is all of her money that she's earning every week from her nursing job is sitting against her salary. Now that means that every dollar that she has got in there is now working against with her mortgage, so that she doesn't pay interest on every dollar that she has got sitting in there. Let's say she gets paid on a thousand dollars a week or whatever. It goes into her account. Well, that's the thousand dollars that she doesn't get charged interest on her mortgage. Then of course, at the end of 55 days interest-free, make sure absolutely then you then pay off that credit card on the day it's due or before the day it's due, so obviously a safer alternative and then pay off the credit card, so you don't pay any interest at all and it's really cool because what that means is that you're really benefiting on the one hand with your mortgage. You're not paying any interest on the credit card and you're utilising your money in the most efficient money flow. Now that's smart thinking when it comes to money management.

In her case, by doing that with her $60,000 salary as well as the other things that we said like the paying it off every two weeks and having and putting into this $60 that she found from extra expenses and things, the can-of-Coke-and-the-sausage-roll story, then her savings came down, it's the interest that she is now not paying is $213,000. So on her $250,000 loan, the actual interest that she'll pay is now only $181,000; remember we started at $394,000 now it's only $181,000 which is an actual saving of $213,000. On top of that, the term of her loan comes down to 15 years, isn't that amazing? 15 years from 30, she has halved it just be doing that and the only thing she has really done that changed her lifestyle at all, is popped in this extra $30 away, well even without, that would be still amazing results. And that doesn't cost her any more, she is just being smart with her money flow. Now remember in the beginning I said that she was $7,200 in bank fees over the term of the loan as well, well that's now reduced to $3,780 and her term of the loan is actually halved. Is that great?

Now she's in a position because she started to get all these things done and she started to get control of her life again really, what we then said is, "Okay, now let's go out and buy positive cash flow property." And I've got a little picture sitting in front of me while I'm talking to you of a little commercial property that she bought. Now it's a little commercial shop in a regional town. It wasn't very expensive and it had flat up the top, so she rented out the flat residentially and she had this little commercial shop that she rented out as well. Now the whole building – the commercial premises cost her $175,000. Now some of you might look at that, "Oh my goodness. That's a cheap property." Well there's plenty of them around particularly out in regional areas and that's what this was, it was little country town, good little town, good occupancy, good support of the town, all that kind of stuff and there's a shop that had been there for six or so years, I think they had four years to run on their existing lease with another option of another five thereafter and they were very very happy to stay on. I mean they're making good money and they're very happy to stay on and the little flat out of the top rented all the time.

So that property, now remember I keep about positive cash flow properties and how I hate negative gearing; well of course this property was positively cash flowed and it was so positively cash flowed, it was making $7,875 a year positive cash flow. What that means is, after paying everything she's going to pay on that property including interest on an interest-only basis on a $175,000 that she paid for the property plus interest on the bits and pieces that she had to pay to get into and like stamp duty and legals and whatever else, she collected every year $7,875, so she didn't even have to get out of bed and that money was started to come in. Of course what I'm going to ask you to do now with that extra income that she gets every year and that actually increases and I haven't calculated in the increases in rent that she will get on this property but ignoring that. If she puts that $7,800 and $75,000 every year into the mortgage, what does it do to it? Well get this, her interest bill now comes down to $111,000 which was sitting up there at $394,000.

She still obviously has to pay the $250,000 but her interest bill now is only $111,000; her fees that were $7,200 and now $2,460 and that's a saving of $287,380, isn't that amazing? $287,000 and the term of her loan is now 10 years now that's taking 20 years of her mortgage by being smart, nothing more, just smart and educated, and I really, really encourage you to go and do this with your own mortgages and calculate what that means to you, just implement those few little strategies that I talked about there because it really does makes such a difference.

I know some of you are struggling with credit cards and things because I get a lot of letters and emails about varying things and a few of you have asked me where do you start, what happens if you've got a lot of credit cards; what happens if you've got AGC cards and credit cards and store cards and AMP cards and all these sort of things, which one you pay first? How do you know where to start? How do you start to apply the re-payments against them because all of them have a minimum re-payment that you have to make. It's like, "Oh, which one do you do first? How do you start that?" So let me just talk about this first.

This is a typical credit card reality. This is where we have to say a $10,000 credit card on a 21% interest. Most people don't realise just how much interest they're paying on their credit cards. This is not an out-of –the-ordinary credit card and if you have one of those, it's just a normal and ordinary credit card with $10,000 outstanding on it and the interest rate was 21%. What that would mean is that your minimum monthly re-payment would actually be a $175 a month. And as much as we all know it's not the right thing to do. Most of us end up just paying that $175. Now if you just pay that $175 which is the minimum re-payment that you have to make without making any more additional purchases, do you know that that loan would take 24 years to pay off and that's only $10,000 credit card -24 years to pay off.

Simply by even implementing the can-of-Coke-and-sausage-roll strategy, it gives us more opportunity to make more and pay off more and we really, really need to be conscious to this kind of stuff because if these things that over time really start to cripple our ability be able to get out there, get in the positive cash flow properties and start to really make some ground in our personal wealth.

I have some scary statistics here for you before I get into what I call the 'avalanche strategy'. Australia owes on an individual basis $20 billion on credit cards and that's increasing by around about $8 million a month. Isn't that horrific? They are scary statistics and 25,000 Australians go bankrupt every year and these types of loans and things that get us into trouble, that and buying negative cash flow properties, I mean that will get you there real fast. Unfortunately, there's a big percentage of the Australians that are still spending a lot more than they earn and that's just can't continue.

Anyway, let's get back to this 'avalanche strategy'. If you have a lot of different credit cards, what I want you to do is write them out on a list. Put them underneath each other and then put the amount that you owe beside it, okay? So, write down the amount that's outstanding on each of one of those loans. Now in the next column, what I want you write down is the minimum monthly re-payment that you have to make on each one of those loans, so that's your next column, going across the page. How much is your minimum monthly re-payment?

The next thing that I want you to do is calculate some figures for me, now this is what I call the 'avalanche index' because what we're trying to do is start an avalanche, and an avalanche starts with just a little tiny weenie snow flake and it combines with another one and then it combines with another one and it gets bigger and it gets bigger and as it rolls down the hill, it turns into this huge snow ball so that it can knock down whole trees and houses and everything. It's such a big avalanche and this is how you calculate the 'avalanche index' because what you're trying to do is to work out which one you're going to be applying that little snow ball to first. So here's how you calculate it, so get your calculators out because this is where we need to work out what the 'avalanche index' is on each one of those credit cards or store cards or whatever else you've got there.

What I want you to do, is to take the amount owed and divide it by the minimum monthly re-payment, okay?

As an example, if you owed $5,000 on a credit card say and you take $5,000 divided by a minimum monthly re-payment of let's say a $195, that would give you an avalanched index of 25.64 and basically go down the list and work out an avalanche index on each one.

It's an arbitrary figure unless you know how to use it, so calculate that figure and write them down. You can do this for you home loans as well, you can add that in there if you like to as well. Then beside that in the next column, one you've calculated all of that, I want you to write down the interest that you're paying on each one of those loans. Now, I'm only asking you to do this because most people will say to you, "Oh pay the one off that's got the highest interest rate." That's the one you should be paying? Well that's actually not correct. What you should be paying is the one that's got the lowest avalanche index because what that means is, if you're using the can-of-Coke-and-sausage-roll analogy and your savings say $30 a week. That $30 a week should be applied to the one that's got the lowest 'avalanche index'.

What that means is that it will free up that amount of minimum monthly re-payment more quickly than any of the others. So it's not actually the one that's got the lowest interest rate, so the highest interest rate. It's not the one that you think, "Oh that's got the highest interest rate. You pay that one off first." That's actually not true. What it is, is the one that you can pay off the quickest and the 'avalanche index' shows you the lowest fee, so what you do then is you put a pay off order beside all of those loans in the next column and the one with the lowest avalanche index is the one that you pay first and when you pay that one off, you still take your $30 a week plus whatever your re-payment was on that particular credit card, so whatever the amount, it was the minimum monthly re-payment, let's say it was $50, when there you've got $80 to go and pay of f the next one with the next lowest avalanche index. This is really cool.

I want you all to do that with all of you credit card and it gives you an 'avalanche index' and it gives an avalanche order for which you should be starting to apply the extra can-of-Coke-and-sausage-roll analogy. Obviously a lot of us don't drink Coke or eat sausage rolls but whatever that thing is for you that you can put towards getting ahead.

Now guys, this is few little money management exercises that I want you to do. I really want you to calculate those things for yourself on your own mortgages and your own loans and all that kind of stuff and start to put them into place today. They are good money management skills, and what it means is that you're going to be in the market sooner. You're going to pay off your unwanted debts quicker and you're going to be out there investing in positive cash flow properties in no time.

Even if you're in a fortunate position where you're able to invest in those kinds of properties now, fabulous, great. Let's make it happen but it doesn't mean that you can be sloppy on the home front and not have the money management skills efficient. And believe me, I've been through many periods in my life particularly when I was a single mum looking after my first two children where money really counted and I had to make every dollar count to its biggest capacity and even though things are different now and my life is a whole lot different of what it was back then, my money management skills remain.

There's no point feeding the bank's coffers on silly little things like, making your mortgage re-payment monthly, not weekly. I mean, that's just ridiculous. Why let them get the extra \$100,000 \$200,000 in some cases for you guys that have got \$500,000 and \$600, 000 mortgages. That can be a difference in a couple of hundred thousand, maybe \$250,000 to \$300,000 over the term of your loan, that's more money you're going to have in retirement which would normally have just been wasted in inefficient money skills going off to the banks. That's just futile.

Get those principles in place; put them into place today. Make sure that you're got an efficient money skills, listen to the podcast again, so that you can really understand everything that I've said. Maybe even take a few notes and if you find that it's useful, pass it on to your mates, pass it on to as many people as you can possibly think of that this is going to help because it really affects everybody. And they're just simple little things that make mountains of difference for people over the longer term. It really is the power of compound interest and it's a great habit to get into. This is one those really good habits to have.

So guys that's it for me this week. I hope you've enjoyed everything and I'll be back again to talk to you very very soon. Bye for now and happy efficient money skills.