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Good Debt Versus Bad Debt

Can debt ever be a good thing? The term “debt” implies a significant burden, which it certainly can be.

But the truth is, some forms of debt can contribute to your financial well-being. So what’s the difference between good debt and bad debt, and how can you tell when debt you’ve acquired is doing more harm than good?

Good Debt

Debt is considered “good” when it provides a long-term benefit, such as increasing your income or building wealth. Plus, when you acquire debt responsibly, paying it off in a timely manner can help build your credit score.

Common examples of good debt can include:

- **Student loans:** Student debt has the potential to improve your career opportunities and in turn, increase your future earnings.
- **Mortgages:** In addition to being a major life milestone, owning a home can help diversify your assets and improve your long-term financial stability. Property also tends to increase in value over time.

- **Business loans:** A business loan can help you start or grow an entrepreneurial venture, which can be a huge boost to your net worth over time.

Bad Debt

Bad debt is typically characterized by high interest rates and an inability to repay that debt. It is important to note that good debt like student loans can become bad debt if you take on too much.

Bad debt might include:

- **Credit cards:** Carrying large amounts of credit card debt, particularly on cards with higher interest rates, can lead to a significant financial burden.
- **Payday loans:** Payday loans promise quick cash but come with steep interest rates and require fast repayment. People may end up needing to borrow more to make the payments.
- **Car loans:** Auto loans can be considered good debt, especially if you pay a large down payment and stick to a modest budget compared to your income. However, many auto loans have high interest rates, and new vehicles depreciate relatively quickly.

Have any questions about your financial strategy? Get in touch.

Helping clients get back to the basics of building and maintaining wealth in a tax efficient way.

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