

A step by step guide to obtaining a long  
and prosperous retirement

## Lesson 11 – Sorting Out Debt

Paul and Mary-Ellen Gadd



## Introduction

This document is part of the comprehensive planning material written to assist Kiwi's in their 50's or 60's that are looking at retirement but have no idea what to do, what is needed, and how or where to get help.

This material provides a simple step by step process to create your own retirement plan. It includes a summary guide, road map, lessons and discussion topics to help you prepare for your retirement. It will help you answer questions such as:

- *How much money do I need in retirement?*
- *How much money will I receive from Government Superannuation?*
- *How, and from where, can I get more money?*
- *Where can I safely investment my money?*
- *How much should I put into KiwiSaver?*
- *Should I buy a 2<sup>nd</sup> property, a business, or invest in the share market?*
- *How much do I need to keep aside for a rainy day?*

all from a very New Zealand perspective.

All material can be downloaded and printed from the downloads page on our website:

<http://www.bizextra.co.nz/>

## Document outline

This document is "Lesson 11 – Sorting Out Debt" of the course material.

Most people complete their retirement plan using just the Planning Guide, Roadmap and the Excel spreadsheet that supports the guide. Additional information is provided to support you along the way if you get stuck, don't understand a concept, or just need some further ideas to try out as part of your planning.

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## Latest Version

Market prices, superannuation and benefit rates, Government policies, inflation, costs of living, house values etc. all change on a regular basis. The numbers in this document have been updated to reflect the market position as at July 2024.

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## Lesson 11 – Sorting Out Debt

In retirement you really need to be debt free. NZ Super is not enough for most people to enjoy the retirement lifestyle they have dreamed of. And if you subtract even more money repaying the lifestyle you have already had (your debt), retirement can become very bleak, very quickly.

To sort out debt, you first need to understand the market. Use Form 7 to record details of what your bank, plus other providers, are offering as interest rates on different types of accounts.

You need to understand the options available to you regarding savings, mortgages, credit cards and other loans they offer. This information will help you decide if you should restructure some of your accounts, change banks to get better interest rates, prioritise debts for repayments or restructure or consolidate any of your loans.

A good site to use is [www.interest.co.nz](http://www.interest.co.nz). This is a New Zealand site that provides lots of information about the different banks and their current offerings (savings accounts, term deposit rates, mortgage rates, KiwiSaver funds etc.). Rather than having to visit lots of individual bank websites, you can obtain comparative information all from one place. The numbers presented are generally advertised rates, so there may still be options to sit down with your bank manager and agree a 'better rate'.

While this Option is looking at reducing or restructuring your debts, the information you obtain during your research will also be used in the evaluation of other options in this Step (e.g. Option 5. 'Generating better income with the assets we already have', and 'Option 6. Agreeing your property strategy').

To evaluate this option, first look at each of your debts and identify if they are considered good or bad (or maybe a bit of both). You need to ensure you don't add anymore bad debts to the list, either before or during your retirement, so having a clear understanding of the difference between good and bad debt will help.

What you need is a plan to get rid of your debts, which ones you need to focus on first, and the timeframe it will take to eliminate them. This way you will understand the timeframe that you can free up the extra cash being consumed by debts) for your retirement.

Having debt, costs you money each and every day that you have it. Not only do you have to repay the money you borrowed, the person lending it to you will also be charging you fees and interest for lending you money. They might also want to add penalty fees if you are ever late paying them back. In a worse situation they might come and repossess the item you purchased.

You have probably heard the term 'loan shark'. These are predators that go around lending money and charging exorbitant fees to the person borrowing it. They also have lots of ways they can penalise you, and have big evil looking staff members or associates that will come and take things from you if they think you haven't paid on time.

While bankers dress in suits and own big buildings, you should always consider someone lending you money as a loan shark. Remember Lesson 2, if you have a credit card debt and are making the minimum repayments each month that the bank have asked for, you are really only paying their interest and fees each month and not repaying the amount you borrowed (when you used your card

to buy something). They are deliberately keeping you in debt so they can collect fees off you for even longer. Banks are just well-dressed loan sharks.

Debt has multiple characteristics that you need to understand:

1. The amount owing. At any time this may be greater or less than the amount you initially borrowed
2. The interest being charged each month while you owe money. This may be a fixed rate, or may change from time to time (a flexible rate)
3. The fees being charged each month while you owe money
4. The date you agreed that you would have it all paid back
5. Any minimum repayments you must meet each month
6. What the penalties are if you forget to make a payment or miss a date
7. If there are any other penalties if you repay it back faster or earlier
8. And any security (e.g. your house is the security on a mortgage) that is at risk of being repossessed if you fail to make the required repayments.

For each of your debts, as well as identifying if it is predominately a good or bad debt, you need to identify these characteristics. While you should now know the difference between good debt and bad debt, some debts are really bad, and you need to get rid of those as soon as possible before they come back and haunt you.

By law, when someone lends you money, they are required to supply all this information to you and confirmed that you understood what it all means, before you signed up to accept the loan (the debt). In practice this doesn't always happen. It is usually in such 'small print' you can't read it or understand it, it is hidden somewhere on a web page you can never find again, they changed it without telling you, or they just don't really care what the law says anyway. They are sharks!

Once you understand the characteristics of all your loans, and understand the impact interest rates and duration have on these loans, you can start to look at changing them to see what positive impacts you can make.

In previous lessons you learnt that compounding interest is not your friend with regard to debt.

Once you have a full list of your debts, knowledge about how much each debt is costing you, identified the ones that are good – and those that are bad, you need to prioritise the list to determine which need to be paid back first. While it would help to move any savings from a 1% account to a 2.5% account, it may be better to use those savings to pay off a loan that is costing 15% or 20% instead.

Look at all your debts to try and prioritise them. Just because one has a higher \$ value than another – doesn't mean it should be a higher priority to be repaid. For example, a \$20,000 student loan still needs to be repaid – but if the interest rate is 0% it should be a lower priority than a \$2000 credit card debt incurring a 23% interest rate.

There are many suggested strategies on the Internet regarding prioritising debts for repayment. Some suggest you should pay the smallest first, as the satisfaction of 'knocking one of the list' encourages you to continue onto the next one. Other strategies suggest paying the most expensive one first as it frees up more cash.

FinCap (part of the New Zealand Budgeting Service), suggest the following priorities based on the type of debt each one is:

1. Debts associated with basic expenses. – you can't survive unless you pay for your rent, power or food. Basic needs are number one. You don't want to be evicted or have the power cut off. If you have any outstanding invoices, then pay them.
2. Debts associated with important expenses. While you can go to a laundry, having important items repossessed is a major inconvenience. If you need your car to get to your job the consequences of losing the car outweigh a late payment on a 'Farmers layby' purchase.
3. Medical needs. Again this is about survival. If it is for a prescription, it probably should have been a number 1. If it is an outstanding bill for a procedure already incurred, it is probably a 7 or 8.
4. Debts that may increase or incur penalties. You don't need extra penalties or interest added to the debt. You don't need debts to increase through your inaction.
5. Debts subject to legal action. The court will come knocking and generally have the power to add further penalties.
6. Debts important to family. Family can be more forgiving than creditors. While you may 'want' to repay them quickly as you may have made a commitment to them, there are usually higher priority debts that 'need' to be paid first.
7. Older debts. They have generally already demonstrated they are happy to wait.
8. Other remaining debts. Anything that didn't fall into the above debts.

Hopefully, as you are meant to be approaching retirement, you are not burdened with debt as per the above, and any remaining debt you have relates to 'good debt', i.e. debts you incurred to obtain or maintain an income generating asset.

On the Roadmap you entered the details of your debts. These are summarised on the 'Debt' worksheet in your Retirement Plan spreadsheet. Confirm you have all your debts listed, and you have all the information you need, and that the information is accurate:

1. Confirm that you have all the correct interest rates you are actually paying for your debts. These can change 'overnight', and the bank may have changed these since you last looked. Look at a recent statement you have been sent, calculate the interest based on the last payment you made (there are Excel functions that do that for you), or phone the other party if you have to find out the actual interest rate you are being charged.
2. Confirm you have the latest balance owing and confirmed any details that are in arrears (overdue). Often, you can make the creditor happier if you at least catch up any outstanding amounts and get back onto the regular agreed payment plan that you initially signed up to.
3. Look for any small amounts of debt that you could just clear out of the way e.g. that last \$100 on a hire purchase or store card. It doesn't mean you will, but it is good to know what options you have.

Next, you want to confirm you are at least meeting all your minimum payment requirements on all your debts. If not, you need to fix that before you start incurring penalties and late payment fees, more interest, or they add penalty interest (at a higher rate), all things that are eating away at your income. You don't need to add to the list of problem debts you already have.

The third step of drilling into debt, is seeing if you can use any spare savings to repay any of the high priority debts.

- Check what savings you have that could be applied (or receive a better return) by being used to repay debt incurring interest at say 20%, rather than sitting in a bank account receiving only 1% interest.

John and Jane had money in a term deposit account, while they had bad(credit card) debts. They should be looking at paying off those debts quicker.

And finally, you want to look at debt restructuring to try and reduce the cost of the debt.

- Can you negotiate a better rate for your mortgage than you are paying? What are the other banks offering? Should you change from a floating mortgage rate to a fixed term rate? John and Jane had a floating mortgage at 4.3%, maybe they could shop around and see if they can get a better rate in the market.
- Is it appropriate to borrow some money on the mortgage? and repay some of the other higher interest loans (debt consolidation)?

Use the power of excel, first work out if this is a better option than the current loan terms you are paying, before you sign up to anything.

Once you have determined your strategy to repay debts, update your retirement plan via the 'Debt' worksheet. You can refer back to the spreadsheet to see what impacts the changes have made.



**Next, Investigate the market to determine the current standard interest rates for things such as savings accounts, term deposits, mortgage rates, credit cards and list them below so you can compare them to your own.**

**List any areas where you are not getting 'the best rate' and ideas as to how you could get a better deal.**

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**When you have agreed the interest rates you will be paying, revisit all the interest rates (for savings) and any debts to check you have the appropriate rates recoded somewhere. Also determine the number of years you plan to take repay each debt.**

Update any changes into the spreadsheet, or Form 7, so see what impact his will have on your retirement.

List any assumptions here:

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