Good Debt versus Bad Debt

Debt falls into two main categories – good or bad. Here are some differences between them.

Think of **good debt** as something long-term that will likely have an increased value in the future. Taking out a loan to purchase a house is an example of good debt because homeowners hope that their home will continue to grow, or escalate, in value. Who knows, the house may have doubled or tripled in value when the loan is paid off in thirty years! Student loans are generally thought of as another form of good debt because getting a college degree improves your potential for future earnings. However, there are a lot of complexities surrounding student loan debt. Individuals should carefully consider the type of higher education institution they are hoping to attend, what the associated costs are for attending that institution, and what scholarships or financial aid may reduce the overall cost. In addition, it's important to look at the future job possibilities in the career field you are interested in as well as the expected income for a position in that field. Sometimes individuals take on too much student loan debt relative to their future income and, just like with anything else, it can become problematic. Remember, even good debt accumulates interest.

Bad debt, on the other hand, finances something that will not increase your wealth or have long-term value. Some view a loan for a brand-new car as bad debt because of the depreciation, or loss of value, of vehicles. If you purchase a new vehicle with a loan, instead of a cheaper used car you can afford without a loan, then you are paying the higher price plus interest. You are getting short-term value from the car and it can help fulfill a need for transportation.

Credit card debt is one of the worst forms of debt. Very seldom are credit cards used to purchase something that will provide long-term value. Additionally, you incur interest charges if the balance is not paid off in full within a month of purchase. If the interest rate is 18-20% (which is typical on a credit card), then the monthly payment can increase very quickly. Also, credit card companies charge a late fee if you happen to be late on a payment.