**PAYING OFF LOANS – June, 2018 Gator Bites**

*"One reason why some are always in debt is because they cannot do without the things they do not need."* - Roy L. Smith

Recently a client asked what procedure should be used to pay off loans incurred by the company. The company had some excess cash, and one of the owner's goals was to be debt free. An interesting question. Before deciding which loan to pay off, decide if paying off a loan early is in alignment with your business strategy and Fundamentals (Purpose, Values, and Operating Principles). Our old friend opportunity cost "kicks in" here. Paying off a loan early uses money which could have been earmarked for some other business purpose. In addition, there may be some tax benefits in not paying a loan off early. Talk with your tax preparer before making a decision.

Assuming that paying a loan off early is part of your business and tax strategy, and is in alignment with your Fundamentals, there are four options. No one answer fits all situations. If you have multiple loans and are determining which one to pay off first, consider the following:

1. Pay off the loan with the highest interest rate.
2. Pay off the loan with the highest monthly payment.
3. Pay off the loan with the lowest monthly payment.
4. Pay off the loan with the smallest remaining balance.

Many years ago, I was approached by a young couple in desperate financial trouble. They had bank loans, school loans, car loans, and credit card loans. Their monthly payments on these loans exceeded their take-home pay. Declaring bankruptcy violated their religious beliefs, so bankruptcy wasn't an option. Some of their lenders would not re-negotiate the terms of the loan, such as interest rate or repayment period. One banker told me, "There is no hope for them, so we'll just repossess their car when they stop making payments". However, they did eliminate all their debts, kept their car, and avoided bankruptcy. The strategy was to pay off the loan with the smallest balance first. They contacted all of their creditors and informed them that they would pay each one every month, but only enough to cover the interest due on the loan. This prevented the loan balance from growing (negative amortization). When the loan with the smallest balance was paid off, it freed up cash flow to start applying to the next smallest loan. As each loan was retired, they had additional money available to pay down the next loan. They cut their living expenses “to the bone” and added part-time jobs to their full-time employment. In three years they were debt free.

The best option for you will depend on your unique situation, cash on hand, and business strategy. Unless the situation dictates otherwise, I recommend paying off the loan with the smallest balance first.

GATOR BITE **Pay off the loan with the smallest balance first**