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Snowball or Avalanche: Which is Best For You?

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Making the decision to pay down debt can bring with it mixed emotions. We feel good about taking steps to pay off credit cards, auto loans, student loans or other personal loans. However, we may become concerned about not being able to set aside as much money for our savings account. It is important for us to remember that reducing debt is a form of saving! While it does not have an immediate impact on the funds seen in our savings account, paying off debt is freeing up money.

If you have more than one debt you want to pay off, such as an auto loan and a credit card balance, there are two main strategies to help you decide which debt to pay off first – the snowball method, or the avalanche method. The trick is deciding which method is best for your situation.

The snowball method focuses on the balances of each loan. In this strategy, you make the minimum payment on all of your accounts except the one with the smallest balance. For this debt, you put as much money as you can toward it and when it is completely paid off, you focus that money to the next smallest balance. Your confidence gets a boost every time you see an account balance at zero!

The avalanche method focuses on the interest rate of each loan, vs. the overall balance. In this strategy, you pay the minimum payment on all your accounts except the one with the highest interest rate. You apply any remaining money you have for debt repayment to the highest interest rate loan. By paying off the debt with the highest interest rate first you reduce the overall amount of interest you must pay.

Deciding which method to use is based on your overall budget goals. If you are wanting to reduce the number of debt payments you have each month, the snowball method may be your best option. If the higher interest rate is on one of the debts with a higher balance, it may take you longer to eliminate one payment. This may cause you to be discouraged and abandon your debt-reduction plan.

If your goal is to save the greatest amount of money, and not to reduce the number of payments you have each month, then the avalanche method is right for you! You will see an immediate impact in the amount of interest you are paying each month, especially if this debt is a revolving account, such as a credit card.

Once you are on a path of reducing your debt, it is important to take time to reflect on the type of relationship you have with credit. Credit is a tool to help you reach your financial goals. When used wisely and with purpose, credit can help you build financial confidence. Having a clear view on when and for what purpose you use credit is the foundation for a positive relationship.

Many times we hear debt referred to as good (home mortage) or bad (credit cards). This classification is based only on the financial aspect of the debt, and not on the personal situation someone might be dealing with. Rather than looking at debt as good or bad, it may feel better to ask yourself if the type of debt you are taking on is a good decision for you or not.

If you are in the middle of a financial blizzard with your credit right now, choose the snowball fight or harness the power of that avalanche. As you find your way out of the blizzard, keep in mind that making purposeful choices about credit can help you build more financial confidence. This confidence will help you reach your goals and plan for the future – helping you avoid financial blizzards down the road!

Source: America Saves. To reach K-State Research & Extension Marais des Cygnes District offices, please call Paola (913-294-4306) or Mound City (913-795-2829), write to kgoul@ksu.edu or check out our website: www.maraisdescygnes.k-state.edu.