Let's Talk Finances

Deciding Which Debt to Pay Off First

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Whether it's from credit cards, student loans, car loans, or mortgages, chances are that you're carrying some level of debt. On the surface, managing debt can seem relatively easy – just make minimum payments. However, if you'd like to make some progress toward actually paying off your debts, you have some choices to make. Which debt should you prioritize? Here's a look at the advantages and disadvantages of several popular strategies.

Pay off the highest interest debt first
To make your money go the furthest, some financial advisors recommend prioritizing the debt with the highest interest rate. With this strategy, you'll get rid of the costliest debt first, so you'll save money in the long run. However, there are potential downsides to this strategy. It's possible that this debt may also have the highest balance – such as a mortgage or a student loan. It can be extremely discouraging to spend years putting your money towards paying down a large debt without seeing much progress on anything else.

Pay off the lowest balance debt first
If you are looking for a quick feeling of accomplishment, consider paying off your low-balance debts first. This can create some debt-reduction momentum that may encourage you to faithfully stick to your plan. Although you'll ultimately pay more in interest over the life of the loans, this strategy is very effective for many people.

Pay off high-credit-utilization debt
If you're one of the many borrowers who'd like to improve your credit score, you may wish to make it your goal to improve your credit utilization ratio. To do this, start by focusing on credit cards with balances higher than 30 percent of their credit limit. When your credit score goes up, you may be able to secure better interest rates on your future loans.

Consider tax breaks
While paying interest can feel like bleeding money, certain types of loan interest qualify for tax breaks. Although this doesn't mean you should stall your progress on these loans, you may see advantages to tackling your non-tax-deductible loans – such as credit cards – first.

When you consider your unique goals and financial situation, you may find that a combination of these approaches may best suit your needs. For example, you could pay off a few small debts, then switch gears and chip away at your high-interest loans. For additional guidance on paying down your debts, you may wish to consult with a financial planner. You can also search online for a debt repayment calculator, which can give you a clearer idea of how much interest you'll be paying, how large your monthly payments should be and how long it will take to pay off your debts.