

MONEY MANAGEMENT

How to Get Out of Debt

Individuals and families turn to credit as an extra source of income. People use credit because it is easily available. As the debts pile up, families who overuse credit find themselves robbing Peter to pay Paul. Each month families juggle their money to pay the bill that squeaks the loudest.

The Danger Signals of Too Much Debt

If many of these danger signals seem familiar to you, then you may be headed for financial trouble.

- ◆ You think of credit as cash, not debt.
- ◆ Your debts are greater than your assets.
- ◆ You owe more than seven creditors.
- ◆ You are an impulsive or compulsive spender.
- ◆ You and your spouse are dishonest with each other about your use of credit.
- ◆ You don't know how much your monthly living expenses are or how much your total debt is.
- ◆ Your expected increase in income is already committed to paying off debts.
- ◆ You depend on extra income, such as earnings by a second person or overtime by the breadwinner, to help you make ends meet.
- ◆ You have less than two month's take-home pay in cash or savings where you can get to it quickly.
- ◆ You have to pay back several installment payments that will take you more than twelve months to pay off.
- ◆ You have more than 20 percent of your take-home pay committed to credit payments other than your home mortgage.
- ◆ You get behind in utility or rent payments.

- ◆ You have to consolidate several loans into one or reduce monthly payments by extending current loans in order to pay your debts.
- ◆ Because you cannot afford to pay for regular living expenses or credit payments, you
 - Are being billed for payments
 - Take out a loan
 - Withdraw savings
 - Skip payments
 - Pay only the minimum amount due on your charge cards

If four or more of the above descriptions apply to you, examine your spending plan and look for ways to tighten your belt. If five or more describe you, you are probably headed for financial trouble and need a solid plan for avoiding more debt. If you chose seven or more, you are in financial danger and should begin a plan now for getting out of debt.

Score	Financial status
4 or more	You need to tighten your belt
5 or more	You are headed for financial trouble.
7 or more	You are in financial danger.

How to Get Out of Financial Trouble

Do you find yourself with more bills than your monthly income can cover? If so, there is a way that you can get out of debt. You can set up your own debt management plan. Completing this debt management plan will take patience. You will have to stick with it until all of your debts are paid. A debt management plan will work if you really want to get out of debt.

You need to start getting out of debt right now. Paying a little back is better than doing nothing or just worrying about the problem. Paying back a small amount will give you a sense of control. It

will start you on your way to solving your financial problems.

To set up a debt management plan, follow these steps:

- ◆ Determine to whom and how much you owe.
- ◆ Decide how much you can pay back and when you can pay it back.
- ◆ Set up a plan for paying back your debts.
- ◆ Discuss your plan with your creditors.
- ◆ Control your spending by sticking with your debt management plan until all debts are repaid.

Occasionally, look over your plan to see if you are keeping up with your debt and your daily living expenses. If there is a change in your income, you may need to raise or lower your monthly payments.

Getting out of financial trouble isn't easy. You have to admit that you have financial problems and really want to solve those problems. You have to make up your mind that you will pay back your debts within a specified length of time. You have to be willing to discipline yourself to pay back the money you borrowed.

Steps to Financial Freedom

How do you get out of debt? First of all you need to know who you owe and what you owe to each creditor. So the first step is to get out all of your credit statements.

Find Out Who and What You Owe

Determine who you owe and how much you owe. List the following information about each debt. (Use worksheet A.)

- ◆ **Name of company**, address, phone number.
If the debt has been turned over to an attorney or collection agency, also list the name of the attorney or collection agency.
- ◆ Your **account number**
- ◆ The **amounts owed**

Determine a **priority** for paying your debts. Which debt should be repaid first? If you don't have enough money to go around, debts should be paid back based on what will happen if you don't pay your bills. Ask yourself these questions.

- ◆ What is the "secured" status of the loan?
If the loan was cosigned or secured by collateral, pay this back first. If you don't, you may

lose your property. Secured loans are made by pledging personal assets or by cosigning with another person. Unsecured loans are loans you can get on the basis of your signature and good credit rating.

- ◆ What legal action has been taken? If you do not want your wages garnished or the item repossessed, pay the debt back as soon as possible.
- ◆ How much interest are you paying? How much money are you paying to borrow the money? Debts with the highest interest rate are costing you the most.
- ◆ What will happen to you if you don't pay the bill on time?
 - Is there a "grace period" for paying before the creditor takes action to collect?
 - Is there a penalty or charge for late payment?
 - Will the remaining balance need to be paid in full if you miss a payment?
 - Will you be harassed by the creditor?
 - Will you lose your possessions or assets?
 - Will your utilities be disconnected or will you be evicted?
 - If you fail to repay a debt to a family member, will there be hard feelings?

When there's not enough money to pay everything, look at what will happen if you don't immediately pay each debt.

Priority of debt repayment.

First priority	Mortgage or rent Secured loans Insurance Utilities Auto loans Telephone
Second priority	Credit cards Finance companies
Third priority	Doctors Dentists Hospitals

Remember that if you default on a loan you will most likely lose your collateral. Use Worksheet A to list the property that secures each debt. Note the following details:

- ◆ Whether legal action been taken. If so, what kind (garnishment, repossession)?
- ◆ The total balance owed
- ◆ The date of the month the next payment is due
- ◆ The number of payments left
- ◆ The original monthly payment
- ◆ The amount of money you last paid the company
- ◆ The date of your last payment

Decide How Much You Can Pay Back

Now you know who you owe. The next task is to figure out how much you can pay each creditor. Decide how long it will take to pay back each debt. If your monthly payments are more than you can pay from a month's check, what can you do?

Generally it is good to limit the amount of credit you owe (excluding your home mortgage) to 10 to 20 percent of your monthly take-home pay. If your family earns \$2,500 a month, try to keep your credit payments under \$250 per month ($\$2,500 \times .10 = \250 , $\$2,500 \times .20 = \500).

But if you already have numerous debts, figure out a way to use 25 percent of your monthly take-home pay to pay your monthly notes. You usually need 75 percent of your income to maintain your necessary daily living expenses. The amount of money you may keep for living expenses if you file for bankruptcy will vary depending on your income, where you live, and the court approved budget.

For example, a family earning \$2,500 a month will probably need to keep \$1,875 ($\$2,500 \times .75 = \$1,875$) for basic living expenses. That leaves \$625 ($\$2,500 \times .25 = \625) for debt repayment.

If the monthly minimum payments add up to \$1,200, what can be done? Here are some options for finding money to pay back debts when you owe more than you can afford to pay back on a monthly basis.

Option 1

Keep a record of your current living expenses using Worksheet B. Watch your expenses for a month. See where your money is going. Look for ways to reduce your expenses so you can use the extra money to pay back your debts.

Option 2

What assets do you own? Do you have a savings account, money market fund, or bond you could cash in to help pay off your debts? Do you have a television, furniture, stereo, car, jewelry, antiques, stocks, or bonds that you could sell to help reduce your debt payments? Could you cash in or borrow against the cash value of your universal or whole life insurance policy?

Option 3

How can you increase your family income? An extra paycheck will help maintain your present lifestyle while you pay back your debts. However, the additional money won't cure poor management habits.

Following are some ways to add extra dollars to your budget:

- ◆ The main breadwinner may temporarily take a second job or work overtime to get through the financial crisis. Other family members could find a job to help increase family income.
- ◆ If the family earner is disabled, disability insurance payments or worker's compensation may be used for income. If the earner is unemployed, unemployment compensation may be a temporary solution to increase income.
- ◆ Develop personal talents or skills and use them to bring home more income. For example, learn to wallpaper and paint your house. Then you could provide this service not only for yourself but you could also sell your skills for a fee. You could also trade your skills for a neighbor's skills. For example, you could babysit in return for the neighbor making a doll for your child.

Option 4

You may borrow money. A loan will give you extra cash right now but will not change your spending habits. More borrowing will only add to your list of debts and drag you further into debt. Interest rates on loans may be very high if you already have a bad credit rating.

Option 5

Loan consolidation, second mortgages or refinancing are ways to avoid repossession or wage garnishment. You can keep a good credit rating with a loan consolidation. Consolidation may reduce the amount of your monthly payment. However, the dollar cost for borrowing is increased because the borrowing time is extended and you will probably be borrowing at a higher interest rate.

If you can manage to pay your debts without consolidation, you will save yourself some extra expense. Loan consolidation may not improve poor money management habits. A disadvantage of consolidation is that the reduced monthly payment may encourage you to incur new debt.

Set Up a Plan to Pay Back Your Debts

By now, you should have a clear picture of how much money you can manage to pay back and when you will be able to pay it back. The next step is to decide how much you will pay each creditor and how long it will take to pay each creditor back. Try to set up your plan so that you *pay your creditors back within three years*.

The actual debt payment plan may take several forms. You may choose to:

- ◆ Give each creditor an equal amount
- ◆ Pay a larger portion to the creditors you owe the most money, and smaller amounts to the creditors you owe less money
- ◆ Pay according to the action the creditor might take if you don't pay the bill according to the original agreement.

The amount paid to each creditor is confidential to you. Creditors do not have to know the amount other creditors are being paid.

Method A. Pay each creditor equal amounts.			
Debts	Amount owed	Minimum payment required/ month	Amount you can pay/ month
Dept. Store	\$2,456	\$110	\$125
Bankcard	\$3,269	\$135	\$125
Bank loan	\$2,300	\$350	\$125
Bank loan	\$3,500	\$325	\$125
Jewelry	\$775	\$50	\$125
TOTAL	\$12,300	\$970	\$625

Method B. Pay the percentage of total debt obligation represented by each individual debt.				
Debts	Amount owed	% of total debt owed	Minimum payment required	Amount to pay/ month
Dept. store	\$2,456	20	\$110	\$125.00
Bankcard	\$3,269	27	\$135	\$168.75
Bank loan	\$2,300	19	\$350	\$118.75
Bank loan	\$3,500	28	\$325	\$175.00
Jewelry	\$775	6	\$50	\$37.50
TOTAL	\$12,300	100	\$970	\$625.00

To determine percentage of debt owed:

Debt owed a specific creditor/Total debt = percent of debt owed to that creditor

Example: Debt 1 = \$2,456.00/\$12,300 = 20%

To determine the amount you are able to pay back, multiply the total amount you can afford to repay each month (\$625) by the percentage of total debt that belongs to that individual debt (Debt 1 is 20% of total debt.) The amount you can repay x Debt 1's percentage of the total debt owed gives you the amount to repay Debt 1 each month. (\$625 x .20 = \$125.00.)

In other words, you pay back according to the size of the debt. You pay back larger amounts to the creditors you owe the most money.

Don't wait for creditors to contact you. Call the creditors before the bills are due. They will be much more likely to work with you.

Method C. Pay according to the action the creditor might take.

If the creditor is threatening to garnish your wages, you will want to pay something on that debt immediately. The loan company can take back your automobile, whereas the doctor cannot take back the service he has rendered. If there is not enough money to pay both bills, pay the loan company back first, so you can keep your automobile. Put the doctor's bills on hold temporarily, but notify the doctor of your plans and your intention to pay in the future.

We encourage you to pay back everyone. But if there is not enough money to pay back everyone on time, then you have to make a decision about which bill you will pay back first.

Use Worksheet C to set up your debt payment plan.

- ◆ Write down the creditor's name in column 1.
- ◆ Figure out the percent of total debt owed each creditor and write that in column 2.
- ◆ Write down the amount of the original monthly payment in column 3.
- ◆ Decide if you will pay back the debtors by proportions, in equal amounts, or according to what will happen if you don't pay. Write down the dollar amount you can pay each creditor each month in column 4. If the creditor accepts your plan, write down the actual amount you pay each creditor under the monthly columns.

Discuss Your Plan with Your Creditors

Now that you have worked out a plan,

- ◆ Cut up all your credit cards.
- ◆ Don't take out any more loans except in extreme emergencies.
- ◆ Contact each creditor and show them your plan.

Do not avoid your creditors. Go visit them. If you can't visit your creditor, call or write them a letter.

A sample letter to a creditor is at the end of this publication. DO NOT send the letter unless you intend to follow through with the repayment plan. Creditors want their money. They would rather receive a small payment than nothing at all. The creditor would rather have the money than the item you purchased.

Explain to each creditor that you do not have the money to pay back the minimum payment that he or she has specified on the monthly statement. Be prepared to explain the following information to each creditor:

- ◆ Why you fell behind in your payment—layoff, rising taxes, insurance premiums, alimony, divorce, death in the family, poor money management skills
- ◆ Your current income
- ◆ Your other obligations
- ◆ How you plan to bring this debt up to date and keep it current. Tell your creditor the exact amount you will be able to pay back each month.

Stick with Your Plan until Your Debts are Repaid

Tell the creditor what you think is a reasonable plan for paying back the debt. You may even be able to get them to drop interest charges in desperate cases. Come up with a plan that is acceptable to both you and the creditor. Once you have worked out an agreement, stick with the plan.

If you fail to follow the plan that you and your creditor agreed upon, you will harm your chances of getting future credit. Tell your creditors about any changes that may affect your payment agreement. If you owe a large amount of money and your creditors won't accept reduced payments, then you may have to consider loan consolidation, bankruptcy, or the debtor's plan.

Summary

If your debts have piled up and your monthly income is not enough to make your minimum monthly payments, a debt management plan can help you

solve your financial problems. Getting out of debt takes a lot of self-discipline, but it can be done. You can get your spending under control if you are patient. Stick with your plan no matter what.

Turn financial disaster into financial success by following these steps:

- ◆ Find out who you owe and how much you owe.
- ◆ Decide how much you can pay back and when you can pay it back.
- ◆ Set up a plan for paying back your debts.

- ◆ Discuss the plan with your creditors.
- ◆ Stick with your plan until all your debts are repaid.
- ◆ Learn from your experience to use better money management practices.

What you do with your money is up to you. It's up to you to control unnecessary spending. It's up to you to decide whether you'll stay in financial trouble or whether you'll work hard to get out of debt.

Adapted for use in Kentucky with permission of the University of Georgia. Ester McAfee Maddux. 1989. "Money Management: How to Make Your Money Go Further." Athens: The University of Georgia Cooperative Extension Service.

Approved for use in Kentucky by Suzanne Badenhop, Family Resource Management Specialist.

Sample Letter

Your Address

Your City, State, Zip

Date

XYZ Company

Street Address

City, State, Zip

ATTENTION: *Delinquent Account Representative*

Dear Sir or Madam:

Subject: *Your Name*

Your Account Number

The purpose of this letter is to inform you that I have budget and debt repayment problems. I am having trouble making my minimum monthly payment as a result of *(state the reason, for example, medical bills, lost your job, divorce, etc.)*. I hope we will be able to agree upon an acceptable debt repayment plan.

I have taken a careful look at my financial situation. I have set up a realistic, minimum budget for my living expenses and developed a debt repayment program. I am asking each of my creditors to accept a reduced payment. Amounts will be increased as soon as possible until the debt is totally repaid.

I owe *(provide the number; for example, 18)* creditors over *(state the total debt amount; for example \$12,500)*. My asset value is less than *(state the value of your assets; for example \$8,000)*. My only assets are a car with a blue book value of *(state the amount; for example, \$2,500)*, some home furnishings worth *(state the amount; for example, \$1,500)*, and my clothing. My monthly take-home pay is *(state the amount; for example, \$2,500)*. I have *(state the amount; for example, \$625)* left after basic living expenses for debt repayment.

I would like you to accept a partial payment of *(state the amount for this creditor; for example, \$75)* for *(state the number of months to pay this amount; for example, 34 months)*, which will repay my obligation. You may expect the first payment on *(give the month, day, and year; for example, July 1, 2008)*.

I would appreciate your cooperation in working with me to pay off my debts under my circumstances. Thank you.

Sincerely,

Your Name

Worksheet B - Expenses

Date Due	Week	Month	Year
Item			
Savings, Investments			
-Emergency fund			
Housing –rent or mortgage			
Utilities			
-Electricity			
-Gas or other fuel			
-Water			
-Telephone			
-Cell phone			
-Trash pickup			
Home Furnishings & Equipment			
Household Maintenance & repair			
Childcare			
Household Help			
Transportation			
-Automobile payment(s)			
-Gasoline			
-Maintenance			
-Public transportation			
Food & Groceries			
-Meals eaten out			
-Alcohol and tobacco			
Clothing			
Personal Care			
-Laundry/dry cleaning			
-Hair care			
-Spa or health club			
Insurance			
-Automobile			
-Property			
-Home/renters			
-Medical			
-Disability			
-Life			
Medical			
-Doctor			
-Dentist			
-Medicine			
-Other			

Date Due	Week	Month	Year
Item			
Recreation or Entertainment			
-Cable or satellite for television			
-Internet connection			
Business Expenses			
Taxes			
Gifts			
Contributions			
Education or Self-improvement			
Monthly installments			
-Department stores			
-Bank charge cards			
-Oil companies			
-Loans			
-Other			
Miscellaneous			
Total			

