WORKSHOP 7

Thoughts on Debt

For many of us, debt can be a source of anxiety, fear, shame, and hopelessness. Being in debt can take a toll on our economic well-being, our relationships, and our mental and physical health. This section will provide tools, resources, and most importantly, *hope* for getting out of debt.

Similar to the strengths-centered financial Person-Directed-Planning from Workshop 2, you will create a unique and personalized plan for getting your debt under control that works for you, your own needs, and your current situation.

When you think about debt, what kinds of feelings does this evoke for you?

How would you like to feel about debt? Where would you like to be in one year? In three?

Figuring Out How Much You Owe

The first step towards making a plan to pay off debt is to figure out what debts you have and how much you owe. Follow the steps below:

Step 1: Check your Credit Reports. The first step to figuring out what debts you have is to access your credit reports from the three major credit bureaus: Equifax, Experian, and TransUnion. You can get one free copy of the report every 12 months from each credit reporting company.

Generally, creditors report debt accounts to one or more of the bureaus, which add it to the credit reports they maintain. Your credit reports will contain information about credit cards, personal loans, mortgages, and more. Your credit report will list the amount owed on each account as well as its status, payment history, and creditor's contact information.

Visit: https://www.annualcreditreport.com/index.action to access your free credit reports.

Step 2: Gather Any Missing Information. It is possible some accounts won't appear on your credit report. Because of this, it is a good idea to gather all of your account statements to determine if any debts are missing, such as mortgage statements, student loan statements, credit card statements, and statements from personal and/or car loans. Make sure you have a statement from every lender you have borrowed money from.

Step 3: Compare: Add up the remaining balance on all of your statements. For example, if you owe $500 on one credit card, $300 on another, $100,000 on your mortgage, and $15,000 on your car, you would add up all of those numbers to arrive at the total amount of debt you owe. Compare this number with the total debt shown on your credit report. These numbers may not align exactly if you have recently made debt payments, since your credit report does not update instantly. However, the numbers should be close.

If you have debts on your credit report that you do not have statements for, contact the lender to verify the balance owed. If the listed debt on the credit report isn't yours, you will need to correct this error with both the lender and the credit bureau.

Step 5: Create a List of All your Debts. Write down all of your debts, which may include credit cards, student loans, personal loans, or car loans, highlighting 1) who you owe, 2) the amount you owe, 3) the interest rate, and 4) the minimum monthly payment.[89] You can use the chart below. Later on in this workshop, you will learn different methods for organizing this list and paying off these debts

List of Current Debts

	What is the debt?	Who do I owe?	How much do I owe?	What is the interest rate?	What is the minimum payment?
1.					
2.					
3.					
4.					
5.					
6.					
7.					
8.					
9.					
10.					

[89] "John Egan. "How Do I Find Out What Debts I Owe?" *Experian.* April 24, 2021. https://www.experian.com/blogs/ask-experian/how-do-i-find-who-i-owe-money-to/

Debt to Income Ratio

Your *debt to income ratio* is how much you owe in debts vs. how much income you make. It measures your ability to make current debt payments by dividing your debts by your take-home pay. Note that items like groceries and utility bills are usually not included. This number helps us consider how much your monthly debt is compared to your monthly income. Your debt-to-income ratio can be a valuable number -- some say as important as your credit score. Ideally, your minimum monthly debt should be no greater than 36% of your gross income.

Step 1: Calculate your *monthly debt.*

Monthly debt payment:	Amount:
Minimum credit card payment 1*	$
Minimum credit card payment 2	$
Monthly car payment	$
Other debt payment 1	$
Other debt payment 2	$
Expected mortgage payment	$
Total	$

*Your minimum credit card payment is not your monthly balance. It is your required minimum payment. It is recommended to pay as much over the minimum as possible to not accumulate interest.

Step 2: Add up your total *gross monthly income* (the amount you receive before taxes or deductions are taken out). Gross income can include wages, tips, benefits, alimony, business income, capital gains, dividends, CD account interest, pension, and more.

Step 3: Divide your total monthly debt amount by your total gross income.[90]

Monthly debt:	$
Monthly income:	$
Debt to income ratio:	____%

[90] Original material from Peerlink National Technical Assistance Center.

Organizing Payment Methods

The following are strategies that can help you prioritize and take control of your debt. Which one you use will depend on your own financial situation and financial goals, and you are welcome to combine elements from different strategies in order to meet your needs. Regardless of which strategies you choose, the key is to start now and take these first steps toward debt management and financial success.

The Long-Term Strategy

This strategy focuses on the kinds of debts that cost the most over time, such as a car loan, student loans, or a mortgage. The goal is to pay the least amount over the course of years, rather than worrying about month-to-month costs. This is considered the most fiscally responsible way to pay off debt, since it reduces the amount of overall interest you pay.

Order your debts by the longest term (or length) of the debt. For example, if you have two loans, one with an interest rate of 15% and six months left to pay on it, and another with an interest rate of 10% and 24 months left to pay, it's a better long-term decision to concentrate on paying off the 10% loan first. This is because over time, that 10% loan will cost you more in interest charges than the 15% loan will in the next few months.

Organize your debts by looking at which one will cost more throughout the length of the debt, and work your way from most expensive to least expensive.

The Long-Term Strategy & Credit Card Debt

Paying off credit cards is an example of the long-term strategy, because if you make only minimum payments every month, it can take several years to pay off your credit and interest will continue to grow. This is called the *minimum payment trap*:

- A $1,000 credit card at 17% interest will take nearly **7 years** to pay in full if you make only minimum payments, and you will have paid nearly <u>$500 in interest.</u>
- $2,500 credit card at that same 17% interest would take nearly **10 years** and cost almost <u>$1,300 in interest.</u>
- $5,000 at the same rate would take **12 years** to pay in full and cost an additional <u>$2,665 dollars in interest.</u>

These numbers illustrate how making minimum payments on your credit cards costs an enormous amount of money over time. Keep this in mind if you plan on using the long-term strategy.

The key to paying down credit card debt: Pay as much over the minimum as possible so that more of your payment goes toward the principal, rather than for interest payments. Even an extra $50 a month can make a huge impact on the average credit card bill.

If you find you cannot pay extra or enough to make a dent, then a consolidation loan might be your best option. While the monthly payments may be more than that minimum credit card payment, you'll know what the cost will be each month and when the debt will be paid in full.

The Interest-Rate Strategy

This strategy involves organizing your debts based on their associated interest rates. As you know from the previous workshop, interest rates can significantly increase the amount of money you owe on loans and bills. Therefore, this strategy focuses on paying off high-interest debts first to reduce the long-term effects of interest.

To follow the interest-rate strategy, gather all of your bills and order them by their interest rate, with the highest rates as the top priority. Work towards paying off your debts with the highest interest first, then move on to bills with lower interest.

If you decide to use this strategy, it's best to use the Effective Interest Rate (EIR). The EIR takes into account any tax deductions you may receive on the debt, such as the deductions you can receive for mortgage and student loan interest, and is usually lower than whatever is stated on the paperwork. If you are not sure what the EIR of a certain debt is, just go with the listed interest rate, starting with the highest and ending with the lowest.

> **Note**: These tax deductions depend on several factors, and you may or may not qualify. It is best to see a tax professional or do some research online to check eligibility.

The Month-to-Month Strategy

This strategy is best suited for those who are currently unable to meet their debt obligations each month. The goal is to reduce the amount you pay in dollars each month. As such, this strategy is a short-term fix for what are likely longer-term financial problems.

To use this strategy, list all of your monthly bills by ease of payoff. This could mean the smallest amount you owe, or the debt with the shortest term until it is paid in full. After you get one debt paid off, move on to the next, and so on, until you get your monthly budget under control.

If you find yourself using the month-to-month strategy, yet never seem able to get ahead, a debt consolidation loan might be in your best financial interests. Doing so can give you control over your monthly payments by reducing many bills into one. It can also help get the debt paid off in a shorter time frame.

Debt Payoff Techniques: Debt Snowball & Debt Avalanche

Paying off multiple debts can feel impossible, especially if you feel like you're barely making the minimum payments each month. To get out of debt, it is often necessary to accelerate payments. Two strategies to do so are: 1) the debt snowball and 2) the debt avalanche. These techniques can be used on most kinds of debts, such as credit card balances, medical bills, and personal, student, and car loans. However, they do *not* work with mortgage repayments.[91]

With the Snowball Technique: List your debts in order from *lowest balance* to largest. Don't pay attention to interest rates. Put extra money towards your smallest debt, while continuing to make minimum payments on all your other debts, and work your way up. Once you've paid the smallest debt off, move on to the next smallest, and so on, working your way through your list. Continue "snowballing" your debt payments until they are all paid off!

This method can produce fast results for your smallest debts, which can build motivation and encourage you to stick with your debt payoff plan. It is also relatively easy to implement. However, this method can be more expensive in the long run (because you continue to incur interest) and can take longer to become completely debt-free.

With the Avalanche Technique: List your debts in order from the *highest interest rate* to the lowest. Don't pay attention to the balance. Put extra money toward the debt with the highest interest rate, while continuing to make minimum payments on your other debts. You will start at the top and work your way down, focusing on the next-highest interest rate, and so on. Continue this "avalanche" of debt payments until all your debts are paid off! [92]

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[91] Ashley Eneriz. "Debt Avalanche vs. Debt Snowball: What's the Difference?" *Investopedia*, April 28, 2021. https://www.investopedia.com/articles/personal-finance/080716/debt-avalanche-vs-debt-snowball-which-best-you.asp
[92] "Crushing Debt: Snowball vs. Avalanche Method." *Denver Community Credit Union.* https://denvercommunity.coop/financial-education/crushing-debt-snowball-vs-avalanche-method/

This method will significantly reduce the amount you pay in interest over time, which can save you hundreds of dollars, and can be a great way to pay off large amounts of debt relatively quickly. However, this method requires discipline. In order to do the avalanche technique correctly, you need to commit to budgeting out a significant amount of money each month to paying off your largest debt. This method assumes an individual has a steady income in which they can allocate enough money each month to make these additional payments consistently.

These are both fantastic methods for paying off debt in an accelerated manner. Although it may take longer and cost more in interest in the long-run, the snowball technique is likely a better strategy for individuals on a budget who cannot put significant amounts of money toward their debt payoffs every month. You might also choose to combine the methods by choosing a debt that's relatively small but carriers a high interest rate and start paying that off first.

Which technique you choose will depend on your unique financial situation and personality. The best method is the one you can realistically stick to.

Tips for Short-Term Debt Payoff:

- Make paying off debts part of your budget
- Pay off the highest interest debt first
- Do not accumulate more debt
- For past due bills or debt payments, call the creditors and settle on a payment plan. They will work with you and are accustomed to people asking for leniency.[93]

Links for Calculating Debt Payoff:

- http://www.moneychimp.com/features/debt_payment_calculator.htm
- http://www.bankrate.com/calculators/credit-cards/credit-card-payoff-calculator.aspx
- https://www.cnn.com/business/calculators/credit-card-payoff-calculator

Resources for Paying Off Debt:

- https://www.thebalance.com/debt-elimination-plan-2385990
- https://www.nerdwallet.com/blog/pay-off-debt/

[93] "Personal Finance and Economic Empowerment." Presented by Sebastian Rodrigues and Jessica Carrol at Peerpocalypse, 2021.

Additional Options for Paying Off Debt

If paying off debt on your own is too overwhelming, or seems impossible, there are other options you might consider.

Debt Consolidation

You may want to consider merging your multiple bills into one loan. With a debt consolidation loan, the lender pays off your existing debt, and you make one monthly payment to that lender.

Consider consolidation when:

- You need to lower monthly payments
- You need more time to pay off the debt
- You can have a lower interest rate under one loan
- You are willing to make a substantial commitment to learn how to manage your money
- You are willing to stop using your credit cards entirely until their debts are paid off
- It will be easier to manage a single loan than trying to make multiple payments every month

Debt consolidation will not decrease your total amount of debt, but it will buy you time to budget, increase income, decrease expenses, and eventually pay off your debt. You can receive a debt consolidation loan from a bank, credit union, or online lender. Credit unions often offer more flexible loan terms and lower rates, especially for borrowers with low credit scores.[94]

Debt Management Plan

A similar option is to enroll in a Debt Management Plan. This is a structured debt repayment program that does not require a loan. Debt Management Plans are typically administered by a nonprofit credit counseling agency. A financial counselor from the organization helps set up an agreement between you and your creditor. You make one lump-sum payment to the nonprofit agency and they disperse the funds to the creditors as agreed.[95] With the help of a financial counselor, these plans can help you feel less alone in your debt repayments and can help you pay off all your debts more quickly.[96]

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[94] Steve Nicastro and Jackie Veling. "5 Ways to Consolidate Credit Card Debt." *Nerd Wallet,* Aug. 5, 2021. https://www.nerdwallet.com/article/loans/personal-loans/consolidate-credit-card-debt-personal-loan

[95] "Personal Finance and Economic Empowerment." Presented by Sebastian Rodrigues and Jessica Carrol at Peerpocalypse 2021.

[96] "Debt Management Plans." *National Foundation for Credit Counseling.* https://www.nfcc.org/what-we-offer/debt-management-plans/

Getting a Second Loan

Another option is to obtain a new loan and use that to pay off the old one. When you get a new loan, you are usually given 30 days until the first payment due date, which could address an urgent need at that time. This is not as direct an option as debt consolidation but it is a viable approach, especially if you can prolong the maturity date of your debt and pay a lower interest rate.

Credit Counseling

Consumer Credit Counseling Services can help you by negotiating monthly payments, late and over-limit fees, and interest rates with your creditors. Credit counselors from nonprofit organizations can help you set up Debt Management Plans. They can also help you learn how to budget and teach good money management skills so you can improve your financial situation and meet your financial goals. Credit counseling can be expensive, but the upfront counseling costs could save you money in the long-run by helping you get your debts under control. For more information on credit counseling services, visit: https://www.nfcc.org/

Debt Settlement

Debt settlement involves negotiating with a creditor to reduce the principal balance of what you owe. This is done by paying a lump-sum payment to a creditor in exchange for the lender forgiving a portion of your debt. Typical debt settlements can range from 10% to 50% of what you owe. This can be a viable option for individuals who simply cannot pay back the full amount they owe.[97]

File for Bankruptcy

A final, last resort option is to file for bankruptcy. When you file for bankruptcy, a judge and a court trustee examine the assets and liabilities of individuals whose debts have become too overwhelming to be able to pay them. The court decides whether to discharge the debts so the individual is no longer required to pay them, or dismiss the case if they believe the person has enough assets to pay what they owe.[98]

You should try *all other options first* before filing for bankruptcy. Bankruptcy has benefits, but it also has serious drawbacks. Among them is the negative information it adds to your credit record, which remains in the system for 10 years and can negatively impact future credit applications.

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[97] Amy Fontenelle. "Debt Settlement: Cheapest Way to Get Out of Debt?" *Investopedia,* June 16, 2021. https://www.investopedia.com/personal-finance/debt-settlement-cheapest-way-get-out-debt/

[98] "What is Bankruptcy & How Does it Work?" *Debt.org* https://www.debt.org/bankruptcy/

Deciding whether or not to declare bankruptcy is a difficult decision. Bankruptcy will affect your future credit negatively. It may also affect your relationships, your self-image, and your mental health. However, it can also improve your short-term quality of life and possibly keep you from losing your home, car, or other essentials.

Pros & Cons of Bankruptcy[99]

Personal bankruptcy is generally considered the debt management *tool of last resort* because the results are long-lasting and far-reaching. It's the financial equivalent of major surgery – not something you should undergo unless it's absolutely necessary. You should consider the pros and cons carefully before making a decision.

Benefits:

- When you file for bankruptcy, it stops all collection actions by creditors, including foreclosure, repossession, and garnishments. If you have filed with an attorney, they can shield you by handling all inquiries from creditors.
- Most states allow you to exempt your home, car, and other essential assets and items.
- Declaring bankruptcy now can get you started on rebuilding your credit, your finances, and your life sooner.
- While nothing will get rid of student loan debt, bankruptcy can prevent your lenders from aggressive collection action.

Drawbacks:

- You will lose all of your credit cards (unless you pay them off before filing.)
- You may also have to give up some luxury possessions.
- A recent bankruptcy makes it nearly impossible to get a mortgage. It will take about five years to be able to do so again.
- A bankruptcy stays on your credit report for 10 years, making it difficult to acquire credit, buy a home or car, get life insurance, and sometimes even get a job.
- Not all debts may be discharged in a bankruptcy, such as student loans and back taxes.

If you are overwhelmed by your debts, cannot realistically pay them back in less than 5 years, and decide to file for bankruptcy, it is recommended to file with a bankruptcy lawyer. Note that attorneys and filing fees can be expensive and there are usually options for free legal services. To learn more about the steps toward filing for bankruptcy, visit: https://www.debt.org/bankruptcy/

[99] Original material from Peerlink National Technical Assistance Center.

Action Plan for Paying Off Debts

The following is a simple Person-Directed-Planning worksheet for organizing and paying off your debts. You can determine which payment option to use for which debt and when and how you will pay.

Which monthly debt?	How much is still owed?	What is the interest rate?	Payment option:	When will it be paid off?	How will it be paid off?
Credit card #1	$500	$14%	Long-term strategy + Snowball Method	In 6 months	This is my smallest debt (Snowball Technique). I will pay over the minimum each month on this bill, while continuing to make minimum payments on my other debts. Once this bill is paid off, I'll focus on my car loan (my next largest debt).

Planning for the Future:

One year from now, I would like to reduce my debt by:	$
One year from now I realistically think I can reduce my debt by:	$
Three years from now, I would like to reduce my debt by:	$
Three years from now, I realistically think I can reduce my debt by:	$

"If you want to feel rich, just count the things you have that money can't buy."

Unknown Author

WORKSHOP 7: SUMMARY

We began this section by writing down how we feel about debt now and how we would like to feel about it in the future. We acknowledged the toll that debt can take on our mental health and centered our class around **hope**. Getting out of debt is possible.

Next, we followed the steps to figure out how much we owe and how to calculate our *debt-to-income* ratios, which determine our ability to pay off our current debts.

We learned about 3 different methods to organize our debt payments: 1) the long-term strategy, 2) the interest-rate strategy, and 3) the month-to-month strategy. We also learned about the snowball technique, which is the quickest and most efficient way to pay off debt.

Then, we explored some additional payment options, such as debt consolidation loans and debt settlements. The final option we considered was bankruptcy. We discussed the pros and cons of bankruptcy and how it should only be used as a last resort option.

Finally, keeping our financial PDPs in mind, we created an Action Plan for paying off our debts.

How can the topics I learned in this section be helpful for me?

Topic	N/A	How this will be helpful to me:
Thoughts on debt		
Figuring out how much I owe		
Debt to Income Ratio		
Organizing payment methods; the Snowball Technique		
Additional options for getting out of debt		
How bankruptcy works; pros and cons		
Creating a PDP & Action Plan for paying off debts		

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WORKSHOP 8

MENTAL HEALTH, RELATIONSHIPS, & MONEY; FINANCIAL CRISIS PLANNING