Dealing With Debt

Help and Advice about Dealing with Debt Problems

Brought to you by www.quickandeasyloans.co.uk

Dealing with Debt the Easy and Manageable Way

Debt is a four-letter word to many people. It's a major source of stress for an ever-increasing number of consumers. But unless you're independently wealthy, debt is usually a necessity if you want to make a major purchase such as a home or an automobile.

Consumer debt is on the rise, and so are delinquencies. More and more consumers are turning to credit counseling to get their debt under control. And even with the tighter restrictions on bankruptcy, people are still filing. These statistics paint a grim picture of debt, yet consumers are still using their credit cards and taking out loans.

The fact is that debt is not such a bad thing in and of itself. It can help us get the things we need and want. The problem lies in accumulating too much debt. If we're not careful, we can get in over our heads. And once we do, it becomes harder and harder to get out of debt.

By educating ourselves about debt and determining what is a safe level of debt based upon our income, we can avoid falling into a debt trap in the first place. And if we're already in too much debt, there are steps we can take to reduce it.

Good Debt vs. Bad Debt

Yes, there is such a thing as good debt. There are only a few types of debt that fall into this category, but it's important to make the distinction. Some examples of good debt are:

- **Debt incurred to buy a home –** Owning your own home has numerous benefits. But the reason that this is considered a good debt is because a home is an investment. It gains value instead of losing it, so you're putting yourself at an advantage by going into debt as long as you keep your payments current.

- **Student loans –** Getting a college education is a good investment as well. By earning a degree, you put yourself in a position to earn more money over your lifetime.

- **Debt associated with starting a business –** Starting your own business can be a risky proposition, but it's done with the intention of earning money. However, some of the assets you purchase will depreciate rather than appreciating. But for practical purposes, you can consider this a good debt.

There are lots of examples of bad debt. Here are a few:

- **Auto loans –** Having a car is a necessity for many, but a car loan is still considered bad debt. An automobile loses value over time rather than gaining it, so when it's time to sell or trade you will not recover your investment.

- **Credit card debt –** Although credit cards can feasibly be used to purchase things that appreciate, they are in general considered bad debt because of the types of things that are usually bought with them. The overwhelming majority of credit card purchases are things that lose value.

- **Most personal loans –** Personal loans are often taken out to finance purchases of things such as appliances, furniture, and vacations. These are often things we need, and

  a vacation can even help us become more productive, allowing us to potentially earn more. But none of these things appreciate in value, so they are considered bad debt.

Just because a debt is a so-called good debt, that doesn't mean it can't get us into trouble. It's important to keep our good debt at a manageable level. Lenders take our income into consideration when lending us money for this reason. But it's also crucial that we look at our individual situations and not borrow more than we can comfortably pay back.

On the other side of the coin, bad debt is not necessarily taboo. There's no harm in taking on some bad debt to get the things we need and want. But the smart thing to do is keep it to a minimum, only using it for things we really need.

How Much Debt Is Too Much?

The amount of debt that is manageable is different for different people. It depends on our income, our bills, and how much money we need to save each month. But in general, it's best to keep our total debts under 35% of our income.

Bad debt is the most important part of the equation. Ideally, we should keep it under 10% of our income. Anything higher is a sign that you may need to reevaluate your finances.

Calculating your bad debt is easy to do. Simply add up your monthly credit card payments, auto loan payments, and any personal loan payments, then divide that number by your monthly income and multiply by 100 for your debt to income ratio. If you want to figure your total debt ratio, add in your student loan payments, mortgage or rent, and any other monthly obligations you have, divide by monthly income, and multiply by 100.

An Ounce of Prevention Is Worth a Pound of Cure

The best thing we can do to avoid ending up in a vicious cycle of debt is borrow wisely in the first place. By remembering three simple things before we borrow, we can keep our debt manageable from the start.

1. **Shop around for the best possible rates.** When buying a car or a home, we almost always compare several options before settling on one. We should always do the same when obtaining credit. Whether it is a mortgage, a car loan, or a credit card, getting the best rate you can get will end up saving you a lot of money in the long run.

2. **Use credit wisely.** If you can do without it, you're usually better off paying cash for it. Many people keep credit cards for emergencies, only to end up declaring a state of emergency when those expensive shoes they've been eyeing go on sale. While one impulse purchase probably won't hurt anything by itself, it can easily become a habit. And that spells trouble.

3. **Pay your debt off as quickly as possible.** If it's a mortgage or loan, add a little extra to the payment each month if you can, or better yet make an extra payment every now and then. For credit cards, pay off the balance in full each month. If that's not possible, pay as much as you can afford. Paying only the minimum payment each month will keep you out of trouble with the credit card company, but it will also allow interest charges to build up.

These steps sound easy, and they are. But it's also easy to slip up a time or two. When we do and it doesn't cause any major problems, we often tend to become more lax on watching our credit habits. That leads to more mistakes, and those mistakes lead to more debt. If it continues, we can end up in too much debt.

Signs That You're in Too Much Debt

Figuring out your debt ratio can give you a good indication of where you stand. But sometimes you don't need to crunch the numbers to know that you're in trouble. And even if your debt ratios are at what is considered a safe level, your individual circumstances could still put you at risk. Here are some of the early warning signs that you may be getting in too deep:

- **You're only making the minimum payments on your credit cards each month.** If you only make the minimum payment each month, it can take years to pay off even a small balance. And you'll end up paying for your purchases many times over because of the compound interest.

- **You use your credit cards for basic necessities on a regular basis.** If you're buying groceries or clothes with your credit card and not paying the balance in full every month, you could be headed for disaster.

- **You charge more than you're paying each month.** Maybe you're paying more than your minimum payment each month, but then you charge more than what you paid the next month. Even though you're paying a little extra each month, things are still going in the wrong direction.

- **You aren't putting anything into savings.** Having all of your money tied up in debt doesn't leave anything in case of an emergency. You might think you can live off of your credit cards in a pinch, but that will lead to nothing but a financial disaster.

The above signs are cause for concern, but they signify the early stages of a problem. If you take action quickly, you still have a chance of turning things around before it's too late. The following scenarios signify a need for immediate, drastic action:

- **You're not sure just how much you owe.** If you have accumulated so much debt that you can't even estimate how much you owe, that is a bad sign. Add it up, and you will likely find that it is much more than you thought.

- **You borrow from one source to pay another.** Getting cash advances from one credit card to pay the payment on another doesn't get you ahead. It simply transfers your debt from one place to another. You usually end up paying extra fees or higher interest for the cash advance as well.

- **You're approaching your credit limit.** Ideally, we should keep our credit card balances at a fraction of our credit limits. Getting too close to your limit, or going over, is usually a sign that things are out of hand.

- **You get turned down for credit.** If you're in over your head already, the last thing you need to do is apply for more credit. But if you do and are turned down, that's usually a good indication that you're in too much debt.

- **You're making your payments late, or missing them altogether.** If things have gotten to this point, you've probably already figured out that you are in too much debt. It's time to start looking at your options for getting out.

How to Get Your Debt Under Control

In order to get debt under control, it is essential to have a plan. If we catch the problem early, we can often get things under control without any outside help. It takes lots of discipline, but with some planning it's not difficult. Here's how to do it.

1. **Stop incurring new debt.** Put the credit cards away. Have your spouse or someone else you trust hide them if necessary. And don't get new cards or take out new loans.

2. **Find ways to cut back on your spending.** Just brainstorm at first. Do you eat a lot of fast food instead of taking your lunch to work? Do you buy a latte

every day? Do you make unnecessary trips? Write these things down to work with in the next step.

3. **Make a monthly budget.** Be sure to include all of the necessities, as well as entertainment expenses and the like. But leave out anything that you can live without from the list you made. And save the loan and credit card payments for last, because you'll need to put as much toward them as possible.

4. **Figure out how much you'll have left over.** This should be split between credit card and loan payments and savings. See the next section for how to determine how much should go to which creditor.

5. **Stick to that budget!** The only exceptions are in the case of a true emergency or when you can find unexpected ways to cut back. When you do find ways to cut back, put the money you save toward paying down your debt.

Prioritizing Your Debts

A frequent stumbling block for those who are trying to get their finances in order is figuring out what to pay off first. We know that we need to make the minimum monthly payment on each bill, but what do we do with the rest of the money we've budgeted toward paying down our debt? We prioritize and pay the most important off first, then go down the list until it's all paid.

The most important debt to pay off, or at least keep current, is secured debt. This is debt that is backed by our assets, such as a home or car loan. If we don't make our payments for these on time and in full, the lender can repossess or foreclose. That's bad for us because we lose things that are very important to us, and bad for our credit.

If we owe a substantial amount of money on our homes, it may not make sense to try to pay them off before we pay off other loans and credit cards. Home loans have lower interest rates anyway, so it's okay to postpone paying them off until we get rid of debt with higher interest rates. Just be sure to pay at least the minimum payment each month.

Paying off your auto loan is a good place to start. It will help you get rid of a secured debt, and the interest is often substantial, although probably not as high as your credit cards. You could put all of your extra money toward your car loan until it's paid off, or you could put a portion of it toward the credit card or personal loan with the highest interest rate. If you have other secured debts, attend to them before moving on to the unsecured ones.

Once your secured debts are paid off, go through your unsecured debts in the order of highest interest rate to lowest. Pay the minimum payments on everything except the one with the highest interest until it's paid off, then move on to the one with the next highest interest rate. Repeat until they're all paid off.

When you're done with the credit cards and loans, pay off any accounts you have outstanding with service providers and such. This includes doctor and dentist bills, and anything else you have a balance on. If you owe doctors or others whose services you need on an ongoing basis, you may need to move this up on your priority list.

And last but not least, pay any family and friends who you owe money. They are usually more patient than regular creditors, and they won't report you to the credit bureaus. Throw in a little interest for their trouble. You should be able to afford it now that you've paid off all of your other debts.

If you have a mortgage payment, now is a good time to pay extra on it. Doubling up on your payments can get it paid off many years sooner than it would be otherwise.

What to Do with the Credit Cards When They're Paid Off

Once your cards are paid off, it can be tempting to start charging again. But that's the worst possible thing you could do. There is some disagreement as to the best course of action. Here are the things you could do, along with their pros and cons.

- **Keep your cards and don't use them.** Some experts recommend that you keep accounts open in order to improve your credit rating. This can help, but if you're not using the cards it won't help much. And by keeping the cards, you open up the door for temptation. This could also backfire if an identity thief gets his hands on your card number, because you might not detect fraud until it's too late if you're not inspecting your bills as closely as you did when you used the cards.

- **Keep your cards and use them occasionally.** This will build up your credit rating, as long as you pay the balances in full each month. But still, by keeping the cards you could be tempted to run up the balances again, putting yourself right back where you started.

- **Close all accounts except for the one with the lowest interest rate, and use it sparingly.** This is a popular option. It allows you to have a card to use in case you really need it and to improve your credit rating, yet you don't have multiple cards tempting you. But even when you only have access to one credit card, it's possible to get into more debt than you can handle. If you're offered a credit limit increase, turn it down.

- **Close all of your accounts and don't look back.** The only sure way to stay out of credit card debt is to not have access to any credit cards. If you are concerned that you might not be able to help yourself, this may be the best thing. Keep in mind, however, that using credit cards responsibly can build up your credit rating, making it easier to get good rates on loans for necessities in the future.

What to Do if You're In Over Your Head

What if you've tried to make a budget to pay off your cards, but the money to pay them off just isn't there? Well, you have a few options.

- **Start bringing in more money.** You might need to get a second job, or search for a better paying one. There are also some ways you can make extra money from home, such as babysitting or doing direct sales. If it comes to this, putting as much of the additional funds as possible toward paying down your debt will help you get it down to a manageable level quickly.

- **Attempt to negotiate with your creditors.** If you talk to your creditors, some of them may be willing to give you more time to pay, drop late fees, or reduce your interest and your minimum payment. It's possible that they might even settle for a lower amount than you actually owe, although it's rare to achieve this without a lawyer.

- **Consolidate your debt.** Home equity loans, or second mortgages, are often used by people who are in an unmanageable amount of debt to consolidate the debt and reduce interest charges and monthly payments. The trouble is that by doing this, you put your house on the line. You may also pay more in interest than you realize, because even though the interest rate is lower, you will be paying for a longer time. If you choose this route, paying more than the minimum payment each month will save you money.

  It's also possible to get a credit card with a high credit limit and lower interest to transfer existing balances to. Your minimum monthly payment should also be lower. This is less risky than putting your house on the line, but you will pay more interest. If you choose either of these methods, don't fall into the trap of using your cards again. That would defeat the purpose of consolidating and get you in even more trouble.

- **Talk to a credit counselor.** Credit counseling can sometimes help those who have taken on too much debt. A good credit counselor will negotiate with your creditors, getting you lower interest rates and lower monthly payments. Then you will make one payment each month to the credit-counseling agency, which sends the lower monthly payment to each creditor, keeping a specified amount as a fee.

  It is important to make sure you understand all terms of the agreement when you obtain the services of a credit-counseling agency. They should tell you how soon your debt will be paid off and how much you will save in interest. It's also a good idea to check the agency out with the Better Business Bureau to find out if there have been complaints against them.

- **File for Bankruptcy.** This should be your last resort. Chapter 7 bankruptcy wipes all of your debts clean, but you may lose some of your property depending on your individual circumstances. Chapter 13, which is now more common because of changes in the law, sets up a court-ordered payment plan to pay off your debt. Either type will stay on your credit report for 7 years, and on public record permanently.

Debt Isn't Always a Bad Thing

When managed properly, debt can be a good thing. It can help us get the things we need and want in life. It's when we start living beyond our means that it becomes a bad thing.

By borrowing wisely and paying debts off promptly, we can keep our debt under control. We can keep our credit reports in good shape, allowing us to get low interest rates when we need to borrow in the future. And we can life a much less stressful life.

If you see your finances taking a turn for the worse, taking on more debt will only add to the problem. Stop using the credit cards, and take steps to reduce your debt as quickly as possible. Averting disaster is often easier than we think if we're willing to tackle the problem head-on instead of letting it spiral out of control.