

Managing Debt Wisely

Like most people, you probably carry one or more forms of debt, such as a mortgage, student loan, auto loan, credit card balance, or home equity loan. If you use debt wisely, as part of an overall financial strategy, it can be a good thing. Carefully managed personal debt can help you establish a solid credit history, which can help you qualify for future loans and/or enable you to receive a lower interest rate on your borrowing.

On the other hand, debt can sometimes become a bad thing. If you have too much debt, if it causes you undue anxiety, or if it negatively impacts your credit report, your debt may be out of control.

Here are some possible guidelines for developing your personal debt management strategy to help you stay in control of your debt, rather than allowing it to control you:

Set priorities for using debt. Borrow money for things that provide long-term and lasting value. Borrowing for college tuition or to purchase a home can reap future benefits. But, charging an extravagant vacation on your credit card may not be a good use of debt.

Be careful with credit cards. Remember that every time you charge something on a credit card, you will have to pay for it. Don't charge things you can't afford. Try to pay your entire balance each month to avoid finance charges and be sure to make the payments promptly to avoid any late payment fees.

Choose a credit card that provides the right combination of fees, rates and benefits to meet your specific needs. If you pay every credit card bill in full and don't incur finance charges, it may be okay to have a card that has a high interest rate but offers rewards for use (like air miles or money back) or has no annual fee. If you carry over balances and pay finance charges, the interest rate is a more important consideration than other benefits the card may offer.

If you cannot pay your monthly credit card balance in full, always **try to pay more than the minimum amount due**. This will eliminate your balance much faster, save you considerable interest charges (on both your past purchases and, in many cases, on new charges as well), and provide some piece of mind knowing you are taking a prudent action. (Please refer to the side bar for added benefits of paying more than the minimum due.)

If credit cards are too tempting, it may be better to get rid of them. As an alternative to credit cards, using cash, checks, or a debit card for your purchases can eliminate the risk of buying things when you don't have money in your account to pay for them right away.

Pay down your debt. This takes discipline, but it is well worth the sacrifice. Interest charges, particularly those that are not tax-deductible (such as credit card interest), are not a good use of your money. Find ways to pay down whatever you owe as soon as you can.

Eliminate high cost borrowing. If your existing debt has a high interest rate, determine if you can convert it to another type of debt with a lower rate. If you are paying interest on credit card balances, you should try to find a card that offers a lower rate and transfer the higher rate balance. However, be aware of "teaser" rates that may rise to a much higher level after an introductory period.

If you have equity in your home, you might consider a home equity loan to consolidate your debts at a lower rate. Keep in mind, however, that this is another type of debt that you should try to pay off as soon as possible.

Control mortgage expenditures. If you are considering purchasing a home, the type of mortgage you choose (fixed or adjustable) will affect the interest rate. Choose one that best matches your specific needs. If you plan to sell your house soon, you may want an Adjustable Rate Mortgage (ARM) with a lower interest

rate. If you plan to stay in the home or cannot afford any increase in payments should interest rates rise, consider a long-term, fixed rate mortgage.

What if you cannot pay your bills? First, stop incurring more debt - quit using or destroy your credit cards. Then, try to work with your creditors to develop an extended payment schedule. Explain your situation and that you want to pay what you owe. Additionally, they may be willing to negotiate a lower interest rate for you. If you can secure a lower rate, even for limited period of time, work within that time frame to pay down as much as you can at that reduced rate.

Do not bounce checks. In some states, it is a worse offense to write a bad check than to not pay your debt. Additionally, you may incur charges for the bad check. It looks very bad to a creditor if your check bounces.

You may want to consider getting professional help. There are many reputable organizations that can provide advice and support to help you manage your debt. They can also assist you in creating a plan to help you work your way out of debt. Look in your phone book for local options available to you.

Choose a credit counselor carefully, and evaluate their services and any fees involved upfront. If possible, look for one who can provide in-person counseling, and be aware that a “nonprofit” organization may still charge a fee for their services. You may want to check the Federal Trade Commission’s website at www.ftc.gov/bcp/online/pubs/credit/fiscal/htm for further information and tips on credit counseling and debt management services.

Pay More than the Monthly Minimum on Your Credit Cards

Depending on your monthly cash flow and spending habits, the temptation to pay only the minimum on your credit card balance may be great. As tempting as it may be, you should always try to pay more.

Credit card companies usually calculate the monthly minimum payment due as a percentage of your outstanding balance. The percentage is usually more than the interest rate they are charging on your balance, but low enough to make the minimum payment amount seem attractive. After all, they make money by charging interest on what you owe.

The cost of paying only the minimum

As you consider how much to pay each month, be sure you understand how the numbers work. Let's assume you have an outstanding balance of \$5000, the annual interest rate being charged is 12% (1% per month), and the minimum payment is 2% of your outstanding balance.

- If you make the minimum payment of 2% (\$100), and you have no additional charges; \$50 of the payment would go to pay the interest, and your balance would be reduced to \$4950.
- Continuing on this schedule, it would take you **299 months** (almost 25 years) to pay off the balance.
- On the other hand, if you were to pay \$250 each month, you would have the balance paid off in about **23 months**.

As a practical matter, unless you just stop using the credit card altogether, you will probably make additional charges to your account, and interest will be added to the amount due. You, of course, also have the flexibility to decide how much over the minimum you wish to pay each month.

Here are some charts that show how long it will take you to pay off your balance, taking into account any new charges and the amount you pay each month..

Example 1. Assume you start with a balance of \$5000, have an additional \$500 or \$400 of charges each month and have a credit card with a **12% interest rate**.

With \$500 of additional charges each month		With \$400 of additional charges each month	
If you pay this amount each month...	# Payments needed to pay off the balance	If you pay this amount each month...	# Payments needed to pay off the balance
\$600	70	\$600	29
\$700	29	\$700	19
\$900	14	\$900	11
\$1000	11	\$1000	9

Example 2. Assume you start with a balance of \$5000, have an additional \$500 or \$400 of charges each month and have a credit card with a **16% interest rate**.

With \$500 of additional charges each month		With \$400 of additional charges each month	
If you pay this amount each month...	# Payments needed to pay off the balance	If you pay this amount each month...	# Payments needed to pay off the balance
\$600	83	\$600	31
\$700	31	\$700	19
\$900	14	\$900	11
\$1000	11	\$1000	9