

Get and Stay on Track

Debt Management Options



Where should you start?

The first step to determine which debt management tool is best for you is to review your financial situation and your financial goals. Are you trying to increase cash flow? Are you trying to pay off your debts as fast as you can? Are you trying to pay the least amount of interest? These are some questions to review before making any decisions. No one debt management tool or type of credit is right for everyone. The challenge, then, is to contact different lenders and companies, compare options, and select the tool best tailored to your needs.

Power Payments

A power payment is when you determine how much more money you would need to pay on your credit cards or other bills to get them paid off within a desired time frame. If you owe \$5000 on 4 credit cards with 18% interest and your minimum payments total a \$100, it would take 94 months to become debt free and you would have paid \$9,331.32. Increase that payment by \$30 to \$130 a month and you would be debt free in 66 months and save \$1,748.74.

Advantages:

- Pay off debts faster.
- Do not have to take on additional credit.
- Payments are flexible. They can be decreased back to the monthly minimum payments in case of an emergency.
- No pre-payment penalties.

Disadvantages:

- Takes discipline to follow.
- No concrete payoff date.

Helpful Hints:

- Do not close credit cards that still have balances. Doing this may cause your interest rate to increase and you may lose your ability to negotiate with the creditor for better terms. This can also raise a “red flag” on your credit report.
- Put the credit cards away so you are not tempted to charge. Continuing to use your credit card for purchases defeats the purpose of a power payment.
- Do not be afraid to call credit card companies to negotiate better interest rates. The worst answer you will get is NO.

Balance Transfers

Transferring balances to low-interest credit cards can save you money. To do this, you apply for a new credit card and transfer the balance over from a card you already have. Watch out for teaser interest rates advertising very low rates for a short term and then the rate jumps up higher than what you had before. If you are not able to pay off the credit card in that short-term, try to find a card that will offer you a good rate until the transfer balance is paid in full.

Advantages:

- May result in lower interest rates.
- Can help reduce debt faster.
- Gives flexibility as you can pay extra money to pay off debt faster or can reduce payments back to the monthly minimums when needed.

Disadvantages:

- May have expensive cash advance fees or balance transfer fees.
- Promotional rates may rise substantially after the introductory period.
- If you are late with one payment, your interest rate may be raised higher than what it was before you transferred the balance.
- Very small monthly payments can stretch this debt out forever.

Helpful Hints:

- Close out zero balance accounts after transferring a balance. Ask the company to report the account “closed at customer’s request”. This will prevent you from being tempted to charge more debt and from carrying around an excessive amount of available credit.
- If you already have a card with a low rate but are at or close to your limit, call and see if the bank would give you a credit increase to transfer a balance from a high interest credit card.
- Read the fine print to see how your finance charges are computed. You may have two offers with 10% interest but the amount of finance charges can vary depending on how the bank is calculating those charges. Look to see if new purchases and payments are adjusted before the interest rate is calculated.
- Be careful of additional products and services offered with a credit card, such as credit protection insurance. These may be costly and you do not have to accept them to keep an account.

Debt Consolidation Loans

Unsecured debt consolidation loans allow you to pay off your debt and make one monthly payment. If you have collateral you can use, such as a car, you will usually be able to get a more attractive interest rate. For example, if you have a vehicle that is valued at \$5000 and you own it, you could get a \$5000 loan secured with the value of your car. If you default on the loan, the bank can repossess your car to pay the loan.

Advantages:

- One Monthly payment.
- You know exactly when the loan will be paid in full.
- Interest rate and monthly payment may be less than what you are paying on current credit cards and loans.

Disadvantages:

- May be hard to qualify if you are over-extended or have history of late payments.
- Total cost of loan may be higher than with current debts if you do not shop around.

Helpful Hints:

- Check to make sure the interest rate is more attractive than your current credit terms.
- Be careful of using finance companies for Debt Consolidation – you may be paying a much higher interest rate over a bank or credit union.
- Close credit cards after getting a debt consolidation loan so you are not tempted to use credit cards. If you keep an account for an emergency, put it in a drawer at home to prevent impulse spending.
- If you have money in a savings but don’t want to use it to pay down debt, consider taking out a secured loan using your savings as collateral. This will give you a much more attractive interest rate and as you pay down the loan, the money in your savings will become available for you to use again.

Debt Management Programs

A Debt Management Program (DMP) is offered through a non-profit counseling agency like Apprisen/CCCS. This program is designed for people who are over-extended and/or behind on their bills. You make one monthly payment to the counseling agency and they send out that payment to your creditors. It is not a loan and it is not a form of bankruptcy. The average length of a DMP is 3 to 5 years.

Advantages:

- Credit card companies usually will bring accounts current after 3 consecutive payments and stop late and over-limit fees.
- Can stop collection calls, garnishment and other legal actions.
- May result in lower interest rates.
- May result in lower payments.
- One monthly payment.
- Very good way of getting bills under control.

Disadvantages:

- May affect your credit rating.
- Usually are required to give up all credit cards and agree not to take on additional unsecured debt.
- A debt management program usually can not help with secured loans.
- Program is very structured and can take discipline to follow.

Helpful Hints:

- Beware of Credit Counseling Agencies that push you into DMP's without first reviewing your budget and helping you evaluate all your alternatives.
- A good credit counseling service should offer its services for very little cost or no cost. Beware of agencies that require large down payments or have excessive fees.
- Check to see if the agency is accredited and a member of the National Foundation for Credit Counseling (NFCC). Also, make sure that the counselor are certified and bonded.
- If you do enter a DMP, watch your statements closely and monitor your progress. Remember these are still your account and you are ultimately responsible for them.

401(k) or 403(b) Loans

Some employers will allow you to borrow from your retirement plan and repay your account over a period of time. The terms can be flexible depending on your plan guideline. You may want to talk to a Financial Planner before taking this step to ensure you will still be able to meet your future retirement goals.

Advantages:

- No credit check
- Does not report on credit bureau
- Low interest rate
- Interest is paid to yourself

Disadvantages:

- Loan must be repaid according to schedule or the IRS will treat it as a withdrawal and you will have to pay penalties and taxes.
- If you leave your job, you may be required to repay the entire loan immediately.
- Reduces long-term retirement savings.

Home Equity Loans

You can use equity you have built up in your house to get a loan to pay off your debt. For example, if you have a house valued at \$150,000 and have a mortgage loan of \$100,000 you then have \$50,000 of equity in your home. You can get a second loan using the \$50,000 as collateral. Home Equity Loans or Second Mortgages can either be closed in or lines of credit. A closed end loan is usually called a Second Mortgage: you would get a lump sum and make monthly payments to pay back the loan. A line of credit works similar to a credit card: You would either have a checkbook or credit card to use to draw funds as needed.

Advantages:

- Interest rate may be lower than with other types of loans.
- Interest may be tax-deductible.
- Low monthly payments can help improve cash-flow problems.

Disadvantages:

- Risk losing your home if you cannot keep up with payments.
- Repayment period can be 10 to 15 years meaning you could be paying your credit card debt forever.
- If you use up all your equity and need to do repairs, you may be forced to use credit cards again.

Helpful Hints:

- Be careful about lenders offering you more than the value of your home.
- Remember do not sign anything unless you feel comfortable about the terms. If you do sign something, you have three business days to cancel your contract.
- Pay close attention to fees, including: the application or loan processing fee, origination or underwriting fee, lender or funding fee, appraisal fee, document preparation and recording fees, and broker fees which may be quoted as points, origination fees, or interest rate add-on.
- Do not agree to a home equity loan if you do not have enough income to make the monthly payments.

Refinancing Your Mortgage

It may be more cost effective to re-finance your mortgage depending on your current interest rate and the cost of the loan. With cash-out refinancing, you refinance your mortgage for more than you currently owe, then pocket the difference. When you refinance your mortgage, you usually pay off your original mortgage and get a new loan. With a new loan, you again pay the same costs you paid to get your original mortgage. These can include settlement costs, discount points, pre-payment fees and others.

The amount you may save depends on many factors, including your total refinancing costs, whether you sell your home in the near future, and the effects of refinancing on your taxes. The old rule of thumb used to be that you should not refinance unless the new interest rate is at least two percentage points lower. However, even if your rate change is less than one percentage point, you may be able to save money. A lender should be able to tell you how long it will take to break even and to recoup the costs.

Advantages:

- Lower monthly mortgage payments
- Lower interest rate, if rates have dropped or if your credit rating has improved.
- Tax break on the interest part of your payments.

Disadvantages:

- Closing costs and points may be expensive.
- Taking short-term debt and converting it to long-term debt.
- Risk losing your home if you cannot keep up with payments.
- Start over again with a 15 to 30 year mortgage loan.

Helpful Hints:

- Compare the costs and benefits of Home Equity Loan vs. refinancing your mortgage. If you refinance and you have less than 20% equity, you will probably be required to carry mortgage insurance again which can be an additional expense.
- Determine how long you plan to stay in this home, depending on the answer, it may not be cost effective to refinance.
- Compare different terms such as 10, 15 or 30-year loans. Compare variable interest rates, fixed rates and ARM loans to see which is going to meet your needs the best.
- Don't let the promise of extra cash or lower monthly payments get in the way of your good judgment about whether the cost you will pay for the loan is really worth it.
- On both Refinancing and Home Equity; avoid any lender who:
- Tells you, or requires you, to falsify information on the loan application. For example, the lender tells you to say that your loan is primarily for business purposes when it is not.
- Pressures you into applying for a loan or applying for more money than you need.
- Pressures you into accepting monthly payments you can not make.
- Fails to provide required loan disclosures or tells you not to read them.
- Misrepresents the kind of credit you are getting. For example, calling a one-time loan a line of credit.
- Promises one set of terms when you apply, and gives you another set of terms to sign - with no legitimate explanation for the change.
- Tells you to sign blank forms - the lender says they will fill them in later.
- Says you cannot have copies of documents that you have signed.

Student Loans

If you have multiple student loans, you may wish to consolidate them in to one loan or try to get a lower payment. Your options can vary depending on what type of loans you have. This can be an option for someone who is current or in default.

Consolidating student loans mean you would apply for a new loan and they pay off the existing student loan and issue a brand new one. The new loan is in good standing, and has never been late. There are also new rounds of deferments available if needed.

Possible Pitfall: Student loans are simple interest loans. If the loan is a few years old and has accumulated a lot of interest due to nonpayment, consolidation could cost a lot more in interest. On the old loan the accumulated interest isn't accruing interest, but when the new loan is issued, the entire balance is capitalized.

For more information you may wish to contact:

- William D Ford Direct Loan Program 800-557-7392
- Sallie Mae 800-524-9100
- US Department of Education 800-621-3115
- To locate the agency that is servicing your loan 800-433-3243

Apprisen, a national nonprofit credit counseling agency, has been helping consumers manage their finances and get out of debt for over 57 years. Certified counselors provide money management and debt counseling, HUD-approved housing counseling, and financial education in 10 states through local offices and nationally by phone or via the Internet. The oldest nonprofit credit counseling organization in the country, Apprisen was originally known as Consumer Credit Counseling Service (CCCS). Accredited by the Council on Accreditation (COA), Apprisen is a member of the National Foundation for Credit Counseling, and local Better Business Bureaus.