



# Managing Debt

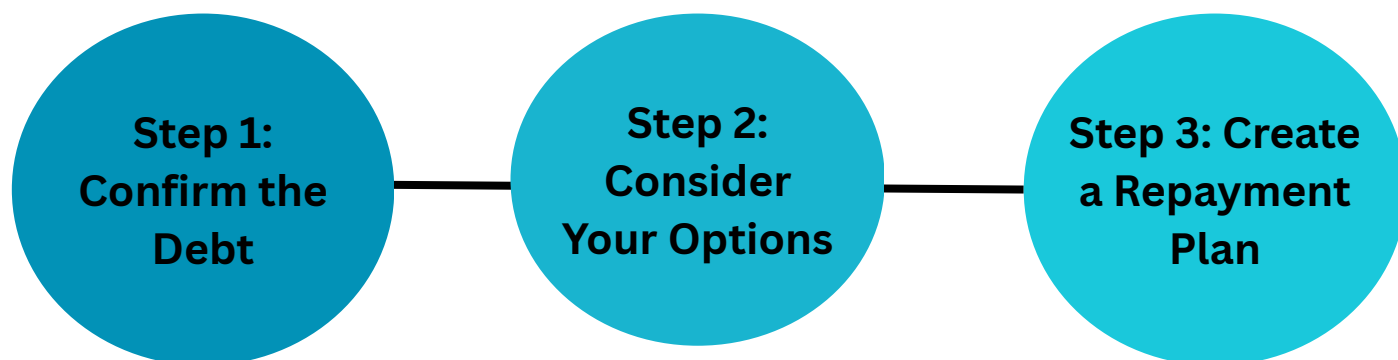
## Introduction:

Of all the concepts and ideas surrounding financial literacy and managing money, debt is perhaps the most daunting for many people. Debt is the money that an individual owes another person or entity when they borrow money. By that definition, everyone in this current day and age will most likely have some amount of debt at any given time.

To clarify, when you use your credit card to pay for something, you are borrowing money from the credit card company to pay for the item(s) you purchased, and so you now owe a debt to that credit card company. As such, debt on its own is not necessarily a bad thing so long as you know how to manage it.

The problems that often arise from debt is when a person is either unaware of how much debt they have or find themselves overwhelmed by how much debt they have to pay off. This often leads to great difficulty getting out of debt, which in turn hurts other aspects of a person's financial literacy such as budgeting and building credit. The purpose of this toolkit is to provide a simple series of steps that a person can take to begin taking control of their debt.

*The steps are as follows:*



## Step 1: Confirm the Debt

The first step to repaying your debts is understanding exactly what you owe. Regardless of where you're at in repaying the debt, there are some things you should always keep track of.

The two that are most important to keep track of are the payment dates and the payment amount. Missing payments or not being able to make a payment in full can result in penalties such as additional fees, or in some cases, if you miss too many payments a collections agent can come to repossess your belongings. For this reason, it's important to keep track of when your payments are due and ensure that you have the proper amount ready to pay.

The next bits of information to keep track of are the terms of the debt and the current interest rate. Knowing the terms of the debt can help determine how you want to go about getting rid of it. Some debts will penalize you for paying it off too early and so it might be a better idea to pay it off in the schedule outlined by the terms.

The current interest rate is also important to know for two reasons. For one, knowing the interest rate can help you to determine how much of your payment is going towards paying off your debt, and how much is going towards interest. Secondly, some debts will have interest rates that change over time, which can impact the amount you pay from deadline to deadline. For these reasons, being aware of your interest rate can help you better plan out your debt repayment.

The final thing you should consider while repaying a debt is who it's from. Knowing who your debtor is, carries the same sort of importance of knowing the terms of your debt. Different debtors might have different options or methods for repayment which can influence what you can and can't do regarding repayment. Not only that, but your debt may go from one debtor to another, causing the terms of the debt to change as well.

While the previous information is good to know and have at any point in the debt process, there is one final piece of advice to consider at the very beginning of debt. If you are going into debt due to a major payment that you must make for either a service or an object, get a complete breakdown of what your costs to make sure you're only being charged for what you're receiving.

For example, let's say you get an injury that requires hospitalization. Once you're recovered, you receive a bill/breakdown listing all the services you received while under the hospital's care. After looking it over, you realize that you were charged for receiving a medication that you know you couldn't have had as you're allergic to one of the ingredients in it.

After realizing this, your next course of action should be to dispute that charge and any other charges you know you did not receive service for. This process may vary from debt to debt, with some situations not having this at all. However, it is a good strategy to use when you are able.

## Step 2: Consider Your Options

Now that you have all the information on your debt(s), the next step is to consider what the best course of action is based on your own circumstances. To help with that, the following is a breakdown of some potential options based on the situation.

Problem	Solutions
I'm having trouble keeping track of all my debts.	Request to change your payment dates, Consolidate your debt, Snowball Method, Consultation
I'm having trouble deciding which debts to focus on first	Snowball Method, High Cost First Method, Consultation
I'm worried I won't be able to pay my medical bill.	Set up a payment plan, Look into seeing if the bill can be reduced/settled, Consultation

## **Step 2.5: An Explanation of Solutions**

### **Consolidate your debt:**

Consolidating your debt is when you take out one massive loan to cover all of your outstanding debts at once, and repay that instead. This can be handy when you don't want to worry about keeping track of several different debts at once though it does have its drawbacks. Firstly, you will most likely be paying more in the long run as a higher loan will mean either a higher interest rate, or a longer period of paying it off. Furthermore, some debts, as mentioned, have prepayment penalties for paying off a debt early.

### **Consultation:**

No matter what other options you end up going with, we recommend including this one as well. Consultation involves getting the advice of a financial advisor who can assess your situation and give you professional advice on what to do next. Consider looking in your area for nonprofits that offer free financial consultation as they will be able to give you advice beyond what is found in this toolkit. If you do end up getting paid consultation, make sure to get in writing what they're offering to do for you, understand how much you're paying up front, and look out for red flags such as them offering to remove your debt entirely or demanding up-front fees.

### **Getting the debt reduced/settled:**

Getting a debt reduced often involves you agreeing with the debtor to pay an amount lower than the initial debt and consider that as full payment. Getting a debt settled is when the debtor agrees to drop the debt entirely. While these may appear enticing, they carry a significant cost of their own. For starters, these options are often only available from very specific debtors, limiting their applicability.

Furthermore, in order to qualify for these options you often have to prove that you are unable to pay the debt as is. In addition to this often being a sign of more serious financial problems, it also potentially means having to provide a significant look into your personal life in order to prove that this is the only option for you. Finally, unless you can convince the debtor otherwise, the debt will show up on your credit report as "Settled" which can greatly hurt your credit score for several years to come, and impact your ability to get a good rate on a loan in the future.

**High Cost First Method:**

The High Cost First Method is a debt repayment strategy where you focus on paying off your highest debts first, and work your way downwards. This will save you the most money in the long run though it can be hard to start. Naturally, your highest debts will most likely have the highest repayment amounts, which can make it difficult to set aside extra money each pay period in order to pay them off early. For this reason, it is not recommended you go with this option if doing so should result in neglecting either your other debts or your personal necessities.

**Request to change your payment dates:**

Some loan providers will allow you to change the date you make loan payments. This most likely won't change the cycle of your pay periods (i.e. you can't change a monthly payment to an annual one), but it can allow you to line up your debts so that your making payments all around the same time. Or conversely, spread out the payments so you don't have to deal with them all at once.

**Set up a payment plan:**

This is specifically for bills (such as medical bills) where the ability to pay in installments is not given up-front. For debts where that is the case (such as credit card debt) the alternative to this could be trying to negotiate a lower amount you need to pay each month. In either of these cases, the result will (hopefully) be a series of payments that you are able to make, with the trade-off being having to hold on to the debt longer, and potentially paying more in interest.

**Snowball Method:**

The Snowball Method is a debt repayment strategy where you focus on paying off your lowest debts early, and work your way upwards. The primary benefits of this method is that it can help clear up the number of debts you need to keep track of, and it also helps to create a feeling of accomplishment as you make a noticeable dent in your debt in a very short period of time. Something to consider with the Snowball Method though, is not to neglect your other debts or necessities in order to achieve it. If you aren't able to set aside extra money while still covering your other costs, then consider holding off for now.

### Step 3: Create a Repayment Plan

So, with your information gathered and your options considered the final step is to put it all together into a plan. While methods and plans are going to vary from person to person, one step we recommend you implement is to use a calendar to keep track of what you're doing and when you're planning on doing it.

Below are some templates you can use as a starting point in your debt repayment journey!

For my \_\_\_\_\_ debt, I'm going to pay \$\_\_\_\_\_ every \_\_\_\_\_, which will allow me to have the debt paid off by \_\_\_\_\_!

Debts in order of importance:

- 1.
- 2.
- 3.
- 4.
- 5.
- 6.
- 7.
- 8.
- 9.
- 10.

To get further involved with our Financial Literacy program, such as one-on-one financial counseling, Orcas Talks Money drop in workshops, or our 7-month Orcas Money Smart cohort, reach out to the Orcas Community Resource Center at 360-376-3184 or [info@orcascrc.org](mailto:info@orcascrc.org) for more information!