



Chapter 4

Debt Management

Like most college graduates, you have a dream of life after graduation that includes making a lot of money and living the good life. Unfortunately, for most college graduates this dream is diminished by the large amount of debt they have accrued during their heydays at college.

The fact is, most college graduates have large amounts of student loans, multiple credit card balances, and a variety of other forms of debt. And, as you know, all of these need to be paid.

But don't give up on your dream of the good life just yet. There is hope. However, it's up to you to make it happen. So how do you make it happen? By putting your debt into perspective and developing a

plan to get yourself out of debt as soon as possible.

Debt Warning Signs

The first step to putting your debt into perspective is to recognize when your debt is a problem. Monitor your debt every month and watch for any of these red flags:

- Living from paycheck to paycheck with nothing leftover at the end of each month.
- Impulse buying. Did you absolutely have to have those new shoes, that 52-inch HDTV, or that new computer?
- Making late or minimum monthly payments on your credit card(s), or skipping payments altogether.
- Having credit cards that are at, or close to, your credit limit.
- Arguing with family members or friends over your spending habits.
- Being unsure of how much you really owe.

- Using cash advances to pay your bills.
- Having more and more of your monthly income that must go to paying off your debts.
- Having your credit card declined, or being turned down for additional credit.

Do you recognize yourself in any of these scenarios? If so, it's time you develop a plan to get out of debt.

Good Debt vs. Bad Debt

As you begin creating a get-out-of-debt game plan, you must first understand what kind of debt you have. There are two types: good debt and bad debt. Your goal is to rid yourself of your bad debts first.

So what is the difference between good and bad debt? It's pretty simple: Good debt is debt that returns something of long term value to you, such as higher education, or home improvements that increase the value of your home. Bad debt can often be categorized as short-term "feel good" debt, like unwise purchases you can't afford and don't really need.

How Much Debt Do You Have?

Now is the time for the reality check. Sit down with paper, pencil and a calculator and start by making a list of all – and we mean all – of your debts. By each of your debts, indicate whether the debt is a good or bad debt. Next, rank them in descending order by their interest rates.

Now, organize your debts. Here is a form you can use:

Good Debts

Name of Loan	Principal Owed	Interest Rate	Annual Interest Payment (Est.)
Mortgage	\$96,552	6.75%	$\$96,552 \times 0.0675 = \$6,517$
Student Loan	\$27,000	4.50%	$\$27,000 \times 0.0450 = \$1,215$
TOTAL			

Bad Debts

Name of Loan	Principal Owed	Interest Rate	Annual Interest Payment (Est.)
Visa	\$5,522	15.75%	$\$5,522 \times 0.1575 = \870
Gas Card	\$648	11.25%	$\$648 \times 1.1125 = \73
TOTAL			

What Is An Acceptable Level Of Debt?

If your bad debt column is blank, and if you have been truthful, give yourself a pat on the back and keep on doing what you've been doing. But if you've got entries in the "bad" column, it's time to do some calculations.

Add up the total amount of interest paid on bad debt. Now, add up the total principle you owe. Figure out your total annual income after taxes. Now make a ratio out of these two numbers.

Using the previous example the ratio looks like this:

Total Bad Debt:	\$6,173
Total Annual Income, After Taxes:	\$32,000
Bad Debt-to-Income Ratio:	$\\$6,173/\\$32,000 = 19.3\%$

As a general rule, anything over 15 percent should sound an alarm and get you motivated to lower it as soon as possible. The goal is to get your bad debt as close to zero as you can, in as short a time as possible.

You may be wondering why good debt is not included in this equation. Good debt helps your overall financial posture. Of course, if you've gone out on a limb with your home purchase, or your student loans are staggering, you may wish to include those numbers in your bad debt equation.

Paying Off Your Debt

Take a good look at your bad debt chart, focusing on the balance with the highest interest rate. This is your starting point. Start your get out of debt plan by paying that one off first. Once you've paid off your most costly debt, don't stop there. Move on to the next one, and pay that off. Work your way down the chart until you have eliminated all your bad debt.

Right now you are probably thinking, "sure, that seems simple enough, but how on earth am I going to find the money to start paying down this bad debt? Here's how:

- **Lose the credit cards** – Put them in a safe, hide them – or even better, cut them up. Start spending cash or use a debit card. That way you can't spend what you don't have.
- **Develop a budget** – Do it with thorough charts, in writing. Study your spending habits, your obligations, and the places where you are most likely to get in trouble. Be sure that your written budget prioritizes the paying down of your bad debt first, but also make sure you can pay down your good debts on schedule, as required. Never let these slide.
- **Live within your means** – Stop all impulse buying, and don't lie to yourself about this. Iron your own shirts. Brown bag your lunch. See the movie when you can rent it for less than half what the theater charges. Shop at thrift shops. Use coupons. Buy only sale items. Eat in, not out. If you're feeling deprived, remind yourself that this is all about your future, maybe even your survival.
- **Pay more than the minimum due each month** – This is a trap set by the bank to own you for eternity. Pay as much as you can stand each month, and then add a few dollars to that. Watch that debt dwindle and congratulate yourself every month.
- **Transfer credit card debt to a low interest card** – If you have too much debt to put onto that card, pay the minimum due on all cards but the worst, and start making as large a monthly payment as you can on that one. It gets easier and easier and feels better and better. Any debts that you can roll into a single debt at a lower interest rate will put money back in your pocket that you can then use to pay down the new, consolidated debt. But be sure to pay very close attention to the fine print involved with these cards, and familiarize yourself with the terms. Understand both the introductory interest rate, as well as what it can grow to and under what circumstances. Many Web sites offer information to help you compare various credit cards to get the best deal. Start with www.bankrate.com or www.cardtrak.com.

- **Refinance your mortgage** – If rates have gone down, consider refinancing. See the Housing: Rent vs. Buy chapter for more information on how to do this.
- **Consolidate student loans** – See the Student Loans chapter for more information on how to do this.
- **Use your savings** – As painful as it is, it makes no sense to let savings sit there and earn a piddling amount of interest (*which is taxable*) when you're paying a much higher interest rate on debt. Paying down your debt technically puts more money in your pocket in the form of interest you no longer have to pay, untaxed, than you can earn on most any savings account.
- **Sell stuff you don't need** – Have a yard sale or sell stuff online. Likewise, if you are driving an expensive car, sell it and replace it with an economy model or, better yet, if you live in an urban area with good public transportation, go carless for a while and see what you save on repairs, insurance and gasoline. Yes, your pride will suffer, but it will suffer worse when you're in bankruptcy court.
- **Use your home's equity** – Review the Home Equity chapter to learn how your home's equity can help you get out of debt.
- **Get a part-time job** – It'll give you a bit of cash to work with and, more to the point, show you that you never want to get into this situation again!
- **Renegotiate with your lenders** – Most lenders will work with you, particularly if your next choice is bankruptcy. Ask for forgiveness on fees, a lower interest rate, and/or a longer repayment schedule.
- **Borrow from your retirement** – "Borrowing" is the important word. And notice that this is listed last. That's because this is not an ideal solution, and should only be considered as a last resort. Before you proceed with this option, consult a professional financial planner. Understand that you are borrowing it from your future, and that you won't have much of a future if you drown in debt before you get there. The terms usually make this an attractive option, because as you pay back the 401(k) plan, the interest you're paying on that loan is being paid to you. But be sure you understand the consequences of this decision. For example, if you decide to leave your job, you must repay the loan within 60 days or you will be subject to various penalties and taxes.

If You Have Too Much Debt

If your situation is beyond the fixes described in the previous section, there are resources to help you.

Financial Advisors

Contact your financial planner, if you have one. He or she can be an excellent source of advice. After all, part of their job is to discuss any financial problems you may have, and too much debt certainly qualifies.

Consumer Credit Counseling Service (CCCS)

If you want to re-negotiate terms with your creditors, you can get free information from the CCCS. Call 800-388-2227 to find an office near you. They will give you general budgeting advice for free, and specific counseling for a low fee.

Keep in mind that CCCS, although marketed as a non-profit organization, is funded in large part (*85 percent*) by fees paid to it by credit card companies in the form of commissions based on collections. This more or less makes CCCS a glorified collection agency, which means it puts the creditor's interest ahead of the debtor's. For example:

- CCCS is unlikely to recommend or even discuss bankruptcy, except to highlight the drawbacks.
- They will put you on a “debt management program” which will require you to pay them a certain sum every month that they, in turn, dole out to your creditors.
- This program favors the repaying of credit card debt and ignores other important debt, like your mortgage and medical bills, from which they get no commission.
- They might suggest that you liquidate your retirement fund, and will not tell you that if you declare bankruptcy, you get to keep your retirement fund.
- CCCS has a cookie-cutter approach to debt management, and will not do much as far as weighing individual circumstances.
- They won't mention that restructuring your credit card debt under their program will have a negative impact on your credit report.

Credit Counselors

Another option is credit counseling groups or credit repair clinics that will work with you for a fee. Be wary of the crooks out there that will take your money and do nothing for you. Be particularly leery of those that promise to “fix your problem fast,” get you a “new credit identity,” or want their fee up front. Also, beware if they promise to get the bad info off your credit report. Bankruptcies, tax liens, judgments and delinquent payments cannot be removed by anyone for any reason.

Investigate any credit counselor you are considering using with the Better Business Bureau www.bbb.org and any other consumer watchdog group. Other useful websites include:

- www.debtproofliving.com
- The Motley Fool www.Fool.com
- The National Foundation for Consumer Credit www.nfcc.org or 800-388-2227
- Federal Trade Commission www.ftc.gov or 877-FTC-HELP

Collection Agencies

If one or more of your creditors has turned a collection agency on you, know your rights.

- A collection agency may contact you by phone, e-mail, fax, mail, or in person.
- They cannot call you before 8:00 a.m. or after 9:00 p.m.
- They cannot call your boss or members of your family.
- No one else can be forced to pay a debt that is yours alone.
- You can get them to stop calling you by sending them a letter. They are then only allowed to contact you regarding plans to bring legal action against you.

You do not need to tolerate rude or belittling remarks. But by the same token, do not take that same attitude with the collection agency. After all, you do owe the money.

Collection agencies are not empowered to work out payment terms. They make money by collecting a percentage of the amount owed, so they will not cut deals on anything other than, perhaps, payment timetables. If you think you are being treated unfairly, contact the FTC at 877-FTC-HELP and ask for information on the Fair Debt Collection Practices Act, or visit their Web site at www.ftc.gov.

Bankruptcy

Filing for bankruptcy should only be done as a last resort. No one loves it, and you should not go into it casually. However, sometimes it's the only course of action left. There are two forms of personal bankruptcy:

- **Chapter 7 Bankruptcy** – will permit you to discharge certain debts.
- **Chapter 13 Bankruptcy** – will give you a debt repayment schedule. It does not discharge debts, but it does make creditors back off.

There are some drawbacks to filing bankruptcy, and you should clearly understand these before taking such a drastic step:

- Bankruptcy will appear prominently on your credit reports for 10 years after you file for it. This means getting more credit will be difficult, particularly for the first few years.
- You are unlikely to be allowed to make a major purchase, such as a home, in the first five to seven years following the filing. Use that time to build up a down payment for a home purchase. Seven years isn't forever. And as a renter, you won't be paying property taxes or spending your money on home maintenance.
- Filing for bankruptcy costs money. It will probably run you some \$1,000 or even more in filing and legal fees.
- Although there is a great emotional benefit to cleaning your slate and starting over, there is stress and some embarrassment that surrounds filing for bankruptcy. It is also unpleasant to have to bare your personal affairs to court personnel, lawyers and creditors, and to have your personal finances placed under court control.
- When you walk out of bankruptcy court after signing the final papers, you will still have shoes on. Most states allow you to protect a certain amount of home equity. In some states (*Florida, Iowa, Kansas, Minnesota and Oklahoma*) you may even be able to keep your home, no matter what it's worth. Most states will allow you to keep home furnishings, clothing, household goods, pensions and retirement accounts, so don't sell these off or empty out these accounts to pay off your debts unless you are certain you will never file for bankruptcy.
- Don't expect to be allowed to keep expensive luxury items like jewelry, boats, multiple cars or other big-ticket items.

While there are significant negatives to declaring bankruptcy, there are some benefits, even beyond having a chance to start over:

- Certain kinds of debts can be wiped away completely, or discharged. Typically, these are:
 - Credit card debts
 - Auto loans
 - Rent payments
 - Medical bills
 - Utility bills

- By the same token, certain kinds of debt cannot be discharged. These are:

- Child support
- Alimony
- Taxes (*both state and federal*)
- Court-ordered fines or damages

A final note about bankruptcy: With your slate wiped clean of the worst of your debts, you are getting a do-over. This means you can breathe easily for the first time in a long while. You can answer the phone again and stop cringing whenever you open your mail. This does not mean that you can go right out and spend like there's no tomorrow. One bankruptcy experience should be enough for anyone. Get credit counseling and resolve to learn from your past mistakes. Now is the time to start working toward a reasonable financial future and retirement.