

Understanding Debt

What is debt?

Debt is money owed to a person or entity that must be paid off by a deadline. For example, mortgage loans, student loans, car loans, and credit card balances are types of debt. Cutting expenses and taking other steps to better manage your money can help you get out of or avoid debt.

How Much Debt is Too Much Debt?

Chances are, at some point in your life, you will have debt. But how do you know if you have too much debt? On average, your annual debt payments (car payments, credit cards, bank loans) should be no more than 20 percent of your annual take home income. (This 20 percent debt guideline does not include rent or mortgage costs that can be 30 percent on their own).

Credit Counseling and Debt Consolidation

If you need help with getting your debt under control, contact a credit counseling agency. Such agencies are designed to assist people who are dealing with difficult financial situations.

The Consumer Credit Counseling Service (CCCS), one of the oldest counseling services in the United States, is part of the National Foundation for Consumer Credit. Local CCCS organizations are listed in the yellow pages under debt or financial counseling. Or, call the national number (1-800-388-2227) to speak with an counselor near you.

If you can't find an office in your area, the NFCC suggests that you ask the following questions to help you choose another qualified credit counseling service:

- Is this agency a non-profit organization?
- How much will these services cost?
- Are agency services confidential and what counseling services are offered?
- Are the counselors and the agency itself certified?
- Are budget and credit education opportunities offered?
- Will my funds be protected?

Tips for Staying Out of Debt

Consider taking one or more of the following steps to help pay off debt or stay out of debt:

- Credit cards - Stop paying high interest rates. Apply for a card with a lower rate but make sure you understand the credit card agreement before you sign it.

Consolidate your credit card debt. Transfer your largest, high-rate balances to a card with a very low rate and really work to pay them down.

Stop using credit cards if possible. Cancel and cut up the credit cards you don't need. Write to the card issuers and close the accounts. (Check terms of use first because some issuers charge a higher interest rate on the remaining balance due to people who close accounts. If this is the case, pay it off and then cancel).

Consider using some of your savings to pay off debt. It may sound drastic but it makes sense if the money in your savings account is only earning interest of 3.5 percent while the price of carrying debt is 15 percent or higher.

- Student loans –

Consider consolidating if you have large student loans. Under the federal Direct Consolidation Loan program, you may combine multiple federal education loans into a new loan. Benefits include no charge for consolidation, a choice of different payment plans, and dealing with one lender and one monthly payment. The interest rate cannot exceed 8.25 percent. Call 800-557-7392 (TDD line 1-800-557-7395) to find out if you are eligible for this program.

- Other debt

Create a monthly budget and stick to it. You may be able to put more money toward paying off debt.

Don't borrow what you can't afford to pay.

Stop overspending. Don't go shopping when you are depressed or upset or when you feel you deserve a "treat." Look for other, less costly, ways to treat yourself well.

Benefits of Staying Out of Debt

Debt is not a bad thing. It is how people manage debt that gets them into trouble. The benefits of not getting too deep into debt are many. Consider:

- Debt can drain your cash. Once you free yourself of debt, chances are you will have more money to spend on things you want or enjoy - without having to worry about interest payments.

- Mishandling debt can lead to a bad credit history, which can have a negative impact if you are applying for a job, trying to get a home loan etc. Managing your debt wisely can put you in a good financial position when it comes to making major purchases.

- Being in debt can be stressful. It can strain relationships at home and could possibly affect your work or school. So, becoming debt free or paying down your debt could make life easier.

http://www.selu.edu/acad_research/programs/cse/finance/manage_money/index.htm