

Getting Out of  
**DEBT**

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## Introduction

Are your finances out of control? If making credit repayments has become difficult, there are steps you may take to improve the situation.

## Self-Help Steps for Overusers of Credit

1. Talk with family members about the situation. All family members must agree to reduce spending until your family is out of this crisis. This may mean closing charge accounts and not using credit cards.
2. Contact creditor(s) and explain the situation. A plan may be worked out so that obligations are repaid.
3. Do not carry your credit cards with you; leave them at home. If you want to use them, you will have to go home and then return to the store. If the item you want to buy is a necessity then you will have access to the credit. If it is an impulse purchase you have the travel time back home to reconsider.
4. Don't ask for credit limit increases. This is a quick fix that may create disaster in the long run.
5. Don't use credit for consumable items such as food if you do not pay in full each month.
6. Beware of debt consolidation. Most consumer finance companies that offer this service charge very high interest rates.
7. If you have more than 15 percent of your disposable income in debt payments, you should take steps to reduce your credit use. Disposable income is your net income after taxes and other payroll deductions.



8. Help may be available from a consumer credit counseling service (if there is one in your area), a financial institution that provides such help, or from the local Virginia Cooperative Extension office. (See pages 6 and 7 of this publication for more information on credit counseling services.)

## Don't Ignore Debts

Many people just ignore debts when they experience financial difficulty. Some fear contacting their creditors. They do not understand the consequences of not paying bills.

Ignoring debts will affect your credit rating. In addition, creditors may seek a judgment in effort to get payment. Or, your bill can be turned over to a debt collector. Your property can be repossessed. Your wages may be assigned or garnisheed. You may be forced into bankruptcy.

## What To Do when Bills Stack up

Several options may help you manage financial difficulties when bills stack up and you cannot pay them. You may set up a debt payment plan and discipline yourself to follow it. This is the most desirable option. If this does not work, seek the assistance of a credit counseling service. You could also choose a court provision, such as bankruptcy, to handle your credit obligations. This should be your last resort.

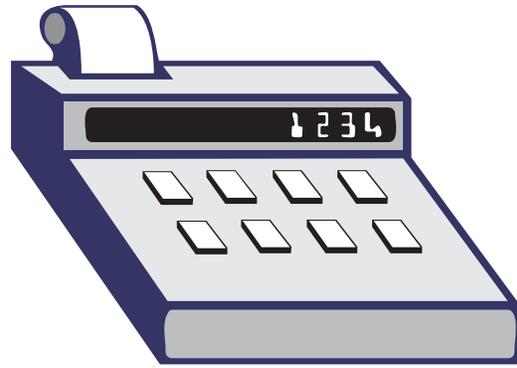
## Developing a Debt Payment Plan

If you have more bills than your monthly income can cover, set up a debt payment plan. This will work if you really want to get out of debt. You have to admit that you have financial problems and really want to solve those problems. Getting out of financial trouble is not easy. You have to make up your mind that you will pay your debts within a specified length of time. You have to be willing to discipline yourself to pay back the money you owe.

You need to start right now. Paying a little back is better than doing nothing or just worrying about the problem. Doing this will give you a sense of control. It will start you on your way to solving your financial problems. Completing this plan will take patience. You will have to stick with it until all of your debts are paid. To set up a debt payment plan, follow these steps:

1. Find out who you owe and how much you owe. (**Worksheet A**, Appendix A)

2. Decide how much you can pay back and when you can pay it back. (**Worksheet B**, Appendix B)
3. Set up a plan for paying back your debts. (**Worksheet C**, Appendix C)
4. Discuss your plan with your creditors or the collection agency or lawyer if they have been turned over for collection. (**See Sample Letter**, Appendix D)
5. Control your spending by sticking with your debt payment plan until all debts are repaid.
6. Occasionally, look over your plan to see if you are keeping up with your debts and your daily living expenses. If there is a change in your income, you need to raise or lower your monthly payments accordingly. Be sure to discuss changes, especially lower payments, with your creditors.



the creditor) or repossession (the creditor takes possession of the property you used as collateral for the loan). If you financed a car, it is likely that the car itself would be the collateral.

- Collection agency or attorney and the contact information. Once a debt has been turned over for collection, all of your correspondence should be with the collection agency or lawyer handling the collection. Be sure to keep receipts or cancelled checks of all amounts paid to be sure that the proper amounts were reported to your original creditor. This is especially important with student loans.

## Find Out Who You Owe

The first step in getting out of debt is to find out who you owe and how much you owe. Get out all of your credit statements. Use **Worksheet A** and list the following information about each debt.

- Name of creditor
- Creditor's address
- Creditor's telephone number
- Your account number
- Collateral (property such as your home, car, land, jewelry, or other assets that secure any debt)
- Interest rate
- Balance owed
- Remaining number of payments
- Monthly payment
- Payment due date
- Amount last paid
- Date last paid
- Type of legal action taken, such as garnishment (a court order that requires your employer to pay up to 25 percent of your salary directly to

## Decide How Much You Can Pay Back

Now you know who you owe. Figure out how much you can pay to each creditor and decide how long it will take to pay back each debt. Generally it is good to limit the amount of credit payments (excluding your home mortgage) to no more than 15 percent of your monthly take-home pay. If your family brings home \$1,200 a month, try to keep your credit payments under \$180 per month (\$1,200 times 0.15 equals \$180). But if you already have numerous debts, figure out a way to use 25 percent of your monthly take-home pay for paying back your monthly debts. You usually need 75 percent of your income to maintain your necessary daily living expenses. A family earning \$1,200 a month will probably need to keep \$900 (\$1,200 times 0.75 equals \$900) for basic living expenses, including savings for an emergency fund. That leaves \$300 (\$1,200 times 0.25 equals \$300) for debt repayment. If the minimum monthly payments add up to \$396, you must try to increase your income or decrease your living expenses. (See *Cutting Costs*, VCE publication 354-155.) Several options may help you repay debts on a monthly basis.

- Option 1. Keep a record of your current income and living expenses for a month (**Worksheet B**). Look for ways to reduce your expenses so you can use the extra money to pay back your debts.
- Option 2. Consider selling assets. What assets do you own? Do you have a television, furniture, stereo, car, jewelry, or antiques that you could sell? Could you cash in or borrow against the cash value of your life insurance policy? Could you borrow against retirement funds? Do you have a savings account or stocks and bonds you could cash to help pay off your debts? Only use IRA or retirement funds as a last resort because you must pay a 10 percent penalty plus income taxes if you withdraw before age 59 1/2.
- Option 3. Increase your family income. An extra paycheck will help maintain your present lifestyle while you pay back your debts. However, additional money will not cure poor management habits. Here are some ways to add extra dollars to your budget.
  - Take a second job or work overtime to get through the financial crisis.
  - Nonworking family members could find jobs to help increase family income.
  - If a family earner is disabled, disability insurance payments or worker's compensation may be a temporary solution for increasing income.
  - Develop personal talents or skills to increase family income. For example, learn to wallpaper and paint your house. This service will save your family money. You could also provide this service to others to increase family income. You could trade your skills for a neighbor's skills, by providing child care in your home in exchange for automobile repair services, for example.
- Option 4. Loan consolidation, home equity loans, or refinancing your home are ways to avoid repossession or loss of income through wage garnishment. These options may reduce the amount of your monthly payment. However, the cost of borrowing is generally increased because you probably will be borrowing at a higher interest rate. If you can manage to pay your debts without loan consolidation, home equity loans, or refinancing, you will save yourself extra expense. Remember, however, that using these options generally does not improve poor money-management habits and the reduced monthly payment may encourage you to acquire more debt.
- Option 5. If your retirement plan at work allows you to make changes to the amount you contribute, you may be able to reduce your portion of the contribution at the beginning of the plan year. This may cost you part of the match from your employer and reduce the amount you have saved over time, but it will increase the amount you receive in your paycheck. You need to be aware that these changes usually must stay in effect the entire year. In addition, since the money will no longer be tax deferred, you will not receive the full amount of the change in your pay check as your federal and state withholding taxes will increase. The increase in taxable income may also put you in a higher income tax bracket, causing you to owe more in federal and state income taxes at the end of the year.
- Option 6. Another way for you to increase your income is to be sure that you adjust your W-4 form to have only the tax you need taken out of your paycheck. If you receive a large refund, you are making an interest-free loan to the government during the year. By adding exemptions on your W-4 (these do not have to agree with the number you claim on your tax return), you can increase your take home pay. Take care that you do not make the number of deductions so high that you owe taxes at the end of the year. If you receive an Earned Income Credit, you may qualify to have part of that credit in your paycheck instead of waiting for your tax refund. To take advantage of these strategies you may want to contact the VITA (Volunteer Income Tax Assistance) program. Contact the Department of Taxation for a VITA program in your area. If you are a senior, contact the American Association of Retired Persons for assistance in preparing your tax returns. These groups may also identify additional tax credits that you are entitled to claim or withholding that can be refunded if you file a tax return.



## Set Up a Plan for Paying Back Your Debts

By now, you should have a clear picture of how much money you can manage to pay back and when you will be able to pay it back. The next step is to decide how much you will pay each creditor per month and how long it will take to fully pay each creditor. Try to set up your plan so that you pay your creditors back within three years.

The actual debt payment plan may take several forms. You may choose to give each creditor an equal amount. Or you may choose to pay a larger portion to the creditors you owe the most money, or a larger amount to the creditors you owe the least money. The amount paid to each creditor is confidential. Creditors do not have to know the amount other creditors are being paid. However, it is helpful to tell the creditor the total amount you owe. For example, you are \$3,380 in debt and your monthly take-home pay is \$1,200. If you use 25 percent of your income for debt repayment, you will be paying back \$300 per month (\$1,200 times 0.25 equals \$300).

**Method A.** You pay each creditor equal amounts.

Debts	Amount Owed	Required Payment	Amount You Can Pay
Car loan	\$1,145	\$180	\$60
Bank card	680	35	60
Bank loan	525	170	60
Bank loan	755	190	60
Jewelry	275	25	60
<b>Totals</b>	<b>\$3,380</b>	<b>\$600</b>	<b>\$300</b>

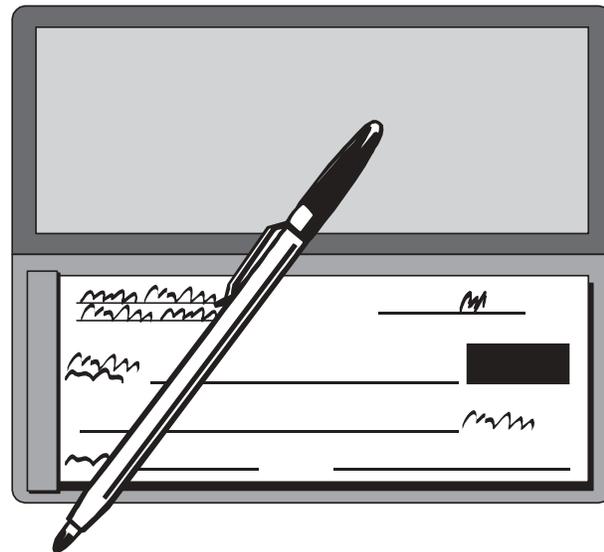
Amount available from monthly income for debt repayment is \$300. You pay each creditor an equal amount: \$300 divided by 5 equals \$60 per month.

**Method B.** You pay back the percentage of total debt represented by each individual debt.

Debts	Amount Owed	Payment Required	% of Total Debt	Amount You Can Pay
Car loan	\$1,145	\$180	34	\$102
Bank card	680	35	20	60
Bank loan	525	170	16	48
Bank loan	755	190	22	66
Jewelry	275	25	8	24
<b>Totals</b>	<b>\$3,380</b>	<b>\$600</b>	<b>100%</b>	<b>\$300</b>

To determine the percentage of total debt owed, make the following calculation: Amount owed divided by total debt equals the percent of total debt owed. If one of your debts is \$1,145 and you owe a total of \$3,380 to all of your creditors, you divide \$1,145 by \$3,380 to get .34 or 34 percent.

To determine the amount you can pay, work this math problem: Total amount you can pay times the percent of total debt owed equals the amount you can pay.  $\$300 \times 0.34 = \$102$



**Method C.** A third method of repayment is to pay back a percentage of the total monthly obligation based on the amount of money available for debt payments.

For example, if you need \$600 per month for debt repayment but only have \$300 per month available for debt payments, this is 50 percent of the amount required. Each creditor is offered a payment in proportion to the amount of the debt (called a prorated payment). In this case it is 50 percent of their regular monthly payments.

<b>Debts</b>	<b>Amount Owed</b>	<b>Payment Required</b>	<b>X</b>	<b>Reduce by 50%</b>	<b>=</b>	<b>Prorated Payment</b>
Car loan	\$1,145	\$180	X	0.50	=	\$90
Bank card	680	35	X	0.50	=	17.50
Bank loan	525	170	X	0.50	=	85
Bank loan	755	190	X	0.50	=	95
Jewelry	275	25	X	0.50	=	12.50
<b>Totals</b>	<b>\$3,380</b>	<b>\$600</b>	<b>X</b>	<b>0.50</b>	<b>=</b>	<b>\$300</b>

**Method D.** You can pay more to the smallest debt so you pay it off fast. Then apply the amount paid to the smallest debt to the next largest debt. How long it will take to you prepay a debt depends on the amount owed and the interest rate. Your county Extension agent may have a program that will figure repayment plans including the interest rate. There are also calculators on the Internet that will figure out how long it will take you to pay off a debt including the interest. The advantage of this method is that you see the number of debts you owe being reduced at a faster rate. Sometimes it is easier to stick to a strict spending plan when you can see quick results for your efforts.

As you can see, you can pay all of your debts, except the car loan, off in 12 months. In this example, the car loan would be paid off in the thirteenth or fourteenth month depending on the interest rate. The time to actually pay off the loans will depend on the interest rates but the principle is the same.

## Setting Priorities

If there is not enough money to make payments on all loans, prioritize your debts. Debts you should pay first include mortgage or rent, utilities, secured loans (such as car loans), and insurance. Second priorities may include credit cards and debts to finance companies (if these are unsecured debts). Some examples of third priorities are doctor, dentist, and hospital bills. Family members and friends usually are willing to wait the longest. If a creditor is threatening to garnish your wages (get a court order to have your employer pay a part of your salary directly to the creditor), you should pay something on that debt immediately. A loan company can repossess your vehicle, whereas the doctor cannot take back the service she or he rendered. If there is not enough money to pay both bills, pay the loan company first, so you can keep your automobile. Put the doctor's bills on hold temporarily, but notify the doctor of your plans and your intention to pay.

<b>Debts</b>	<b>Amt. Owed</b>	<b>Mo 1</b>	<b>Mo 2</b>	<b>Mo 3</b>	<b>Mo 4</b>	<b>Mo 5</b>	<b>Mo 6</b>	<b>Mo 7</b>	<b>Mo 8</b>	<b>Mo 9</b>	<b>Mo 10</b>	<b>Mo 11</b>	<b>Mo 12</b>
Jewelry	275	80	80	80	80								
Bank Loan	525	55	55	55	55	135	135	135					
Bank Card	680	55	55	55	55	55	55	55	190	190			
Bank Loan	755	55	55	55	55	55	55	55	55	55	245	245	
Car Loan	1,145	55	55	55	55	55	55	55	55	55	55	55	300
<b>Total</b>	<b>3,380</b>	<b>300</b>	<b>300</b>	<b>300</b>									

Use **Worksheet C** (Appendix C) to set up your debt repayment plan. Write down the creditor's name in the first column. Enter the total debt owed that creditor in the second column. Write down the amount of the original monthly payment in the next column. Decide how you will repay the debt. Write down the dollar amount you can pay the creditor each month in the fourth column. If the creditor accepts your plan, write down the actual amount you will pay that creditor in the appropriate columns. Repeat these steps for each creditor.

## Inform Your Creditors

Now that you have worked out a plan, do not use your credit cards, do not take out any more loans except in extreme emergencies, and contact each creditor and explain your plan. Go visit each creditor. Remember, creditors would rather receive a small payment than nothing at all. They also prefer to have the money rather than the items you purchased. If you cannot visit your creditor, call or write a letter.

**A Sample Letter to Creditors** is at the end of this publication. (See Appendix D.) Change the facts to fit your situation. Explain to each creditor that you do not have the money to make the minimum payment specified on the monthly statement. Be prepared to provide the following information to each creditor:

- Why you fell behind in your payment (loss of a job, illness, divorce, death in the family, and/or poor money management skills)
- Your current income
- Your other obligations
- How you plan to bring this debt up to date and keep it current
- The exact amount you will be able to pay back each month

Be honest and tell the whole situation. If you tell a creditor that you only owe two companies but you really owe twenty, you could have problems later. If you fail to follow the plan that you and your creditors have agreed upon, you will harm your chances of getting future credit. Tell your creditor about any changes that may affect your payment agreement.

Do not wait for creditors to contact you. Call the creditors before bills are due. They will be much more likely to work with you. If you owe a large amount of money and your creditors will not accept reduced payments, then you may have to consider bankruptcy or loan consolidation. A loan consolidation is a loan that will enable you to pay all of your creditors. Then you have one creditor. This single payment must be manageable in your budget.

## Credit Counseling Services

Sometimes it does not seem possible to manage the problem of being financially overextended. If you are unable to solve your financial problems alone, counseling services can help you set up a budget and debt payment plan. Nonprofit financial counseling agencies charge little, if anything, for their services. Military bases and industries often hire people who can help you manage your debts. Housing authorities, credit unions, churches, and universities sometimes provide financial counseling.

However, you need to be careful when selecting a credit counseling service. *USA Today* reported that the number of complaints about credit counselors was 1,480 in 2002, up from 261 complaints in 1998. Check with the Better Business Bureau to see if complaints have been filed against a credit counseling service before you contact the service.

## Extension's Financial Counseling Service

Selected units of Virginia Cooperative Extension have a Volunteer Financial Counseling Service. Client families are assisted in debt management by trained volunteers. All adult family members must take part in the counseling sessions, which usually are held in public meeting rooms at Extension offices, libraries, or schools. Volunteers are trained to help the family develop a workable budget that will enable the family to repay debts and improve its financial security. The volunteers' primary focus is teaching money management skills. This includes information on:

- Setting up a spending plan
- Contacting creditors for adjustments in repayment
- Putting financial records in order
- Reviewing insurance coverage

- Establishing regular savings based on set goals

If unique problems arise, the volunteers have access to county Extension agents, Extension specialists, and local financial consultants. In other Extension offices, the Extension agent handles credit counseling and group programs. To take advantage of this service, call your local Extension office.

## Consumer Credit Counseling Services

The Consumer Credit Counseling Services (CCCS) help individuals or families with serious financial problems through budget planning, money management, and planned debt reduction. CCCS is a local nonprofit organization affiliated with the National Foundation for Consumer Credit, Inc. CCCS is not a lending institution or charity organization. The counseling service is free. However, when the service prepares a debt repayment plan for you, a nominal fee may be charged to help with administrative costs. They may also require automatic withdrawal from your checking account to cover the amount being disbursed. In addition to client fees, local businesses pay the counseling service a fee for collecting the debts clients owe them. For example, if the CCCS counselor collects \$20 to pay a debt owed to a bank, in addition to the fee charged to client, the bank pays CCCS a sum (such as \$3) for collecting the debt. The CCCS may also be supported by local groups such as the United Way or community minded firms and individuals.

Anyone overburdened by credit obligations can phone, write, or visit a CCCS office. CCCS requires that you complete an application for credit counseling. CCCS will arrange an appointment with a

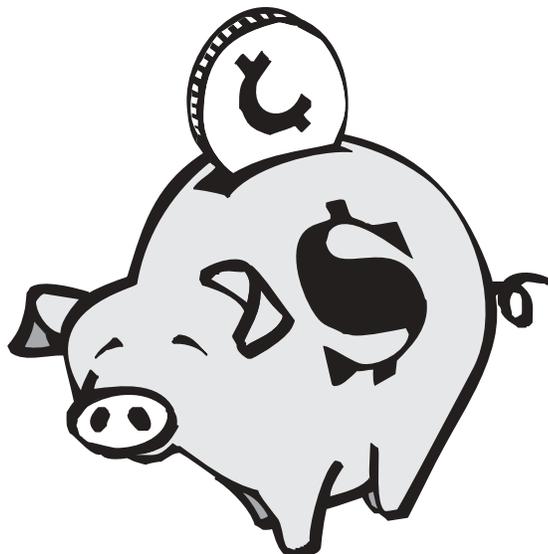
counselor for you. A counselor will review your application. The counselor is qualified to prepare a budget plan that will be given to you and your creditors for approval. The budget plan will outline exactly how each debt will be repaid. The plan usually is all that is required unless there is an emergency or a change in your financial situation. You can return to the counseling service at any time for further advice. They will probably want you to make your payments to them and they will pay your creditors. There is a charge for this service.

## Summary

When your debts are high and your monthly income is not enough to cover the payments, take action to solve your problem. Develop a personalized debt payment plan. If you need assistance to set up the plan, contact a financial counselor at one of the counseling services.

Another way of settling your debts is by court provisions. Your debts will be settled by selling your assets when filing Chapter 7 Bankruptcy. Under Chapter 13 Bankruptcy, the wage-earner's plan, you may keep your assets while paying back your debts. Any form of bankruptcy should be considered the last resort and you would be wise to consult an attorney for counsel.

The road to financial recovery takes total commitment. You have to decide that you want to be debt free. Then you have to discipline yourself to take the necessary action to pay back your debts. Only you can determine if you are willing to make the sacrifices it takes to achieve this goal.



## Credit Registers

You may use a credit register to monitor the use of credit, amounts owed, and to whom they are owed in order to prevent overextension. The sample register below illustrates how you may use this management tool. This form can keep you abreast of outstanding credit obligations. You can easily cross-check between the credit register and the credit statements you received in the mail. This will give you an idea of your credit debt at any time.

When you make credit purchases you need to keep the receipts for future reference. By using a credit register, each credit transaction can be recorded when it occurs. Then even if the receipt is misplaced, some record is available for verification.

### Using A Credit Register

- Write in the dates the credit register covers. You should use a month or the typical billing period for your credit cards.

- Write the names of the credit accounts you have, such as Visa, MasterCard, or Sears in the spaces to the right of "credit accounts."
- Each time you make a credit purchase or payment, record
  - the date
  - the purpose
  - the amount under the column for that creditor
  - add the charge or subtract the payment from the previous balance for that card so that you will have a running total
  - add the charge or subtract the payment in the Summary Balance column. This overall balance will show how much you owe on all credit accounts at any one time.

## Example

Credit Register								
From: 6-1 To: 6-30								
Date	Credit Accounts	VISA		MasterCard		Sears		Summary Balance
		Charge/ (payment)	Balance	Charge/ (payment)	Balance	Charge/ (payment)	Balance	
6-2	Gas	11.50	11.50					11.50
6-4	Clothes	12.00	23.50	69.00	69.00			92.50
6-7	Chair					229.00	229.00	321.50
6-29	Paid VISA	(23.50)	0					298.00
6-30	Gas			13.00	82.00			311.00



## Appendix B

### Worksheet B. Monthly Income and Living Expenses

Income		Week One	Week Two	Week Three	Week Four	Week Five*
<b>Net Pay</b>	<b>Job 1</b>					
<b>Net Pay</b>	<b>Job 2</b>					
<b>Net Pay</b>	<b>Job 3</b>					
<b>Other Income</b>						
<b>Total Income</b>						
Expenses						
<b>Housing</b>	Mortgage/rent					
	Insurance					
	Gas					
	Electricity					
	Water and sewer					
	Telephone					
	Trash collection					
<b>Food</b>	Groceries					
	Meals eaten out					
	Snacks					
<b>Transportation</b>	Car payment					
	Gasoline					
	Insurance					
	License and registration					
	Maintenance and repairs					
	Parking and tolls					
	Rental, taxi, bus, subway					
<b>Clothing</b>	Purchases					
	Cleaning and laundry					
	Alterations and repairs					
<b>Medical</b>	Insurance					
	Prescriptions and over-the-counter medicine					
	Hospital					
	Doctor					

\*Sometimes the month may have an extra week

Expenses		Week One	Week Two	Week Three	Week Four	Week Five*
	Dentist					
	Eye care					
<b>Life/Disability Insurance</b>						
<b>Child Care</b>						
<b>Personal</b>	Books					
	Newspapers/magazines					
	Educational expenses					
	Hair care					
	Cosmetics/toiletries					
	Postage/stationery					
<b>Recreation/Entertainment</b>	Movies, plays, concerts					
	Cable TV					
	Internet					
	Club dues					
	Alcoholic beverages					
	Tobacco					
	Sporting goods					
	Vacation					
	Allowances					
	Donations					
<b>Gifts</b>	Birthdays					
	Holidays					
<b>Other</b>						
<b>Savings</b>						
<b>Monthly Debt Installments</b>	Department stores					
	Bank credit cards					
	Oil company					
	Loans					
	Other					
<b>Miscellaneous payments</b>						
<b>Total Expenses</b>						

# Appendix C

## Worksheet C. Debt Repayment Plan

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Amount to be Paid														
Original Monthly Payment														
Amount Owed														
Creditor/Collection Agency														

## Appendix D

### Sample Letter to Creditors

Your Name  
Street address  
Your city, state, zip

Date

XYZ Company  
Street address  
City, State Zip

Attention: Delinquent account representative

Subject: Your account number

Dear Sir or Madam:

This letter is to inform you that I am experiencing financial difficulties. I am having trouble making my minimum monthly payment because of a ***recent divorce and job change to a lower salary***. I hope we will be able to agree on an acceptable debt repayment plan.

I have evaluated my financial situation. I have prepared a realistic, minimum budget for my living expenses and have developed a debt repayment program. I am asking each of my creditors to accept a reduced payment. Amounts will be increased as soon as possible until the debt is totally repaid.

I owe ***18 creditors over \$7,500***. My asset value is less than ***\$3,000***. My only assets are ***a car with a blue book value of \$1,000, some home furnishings worth \$1,500, and my clothing***. My monthly take-home pay is ***\$708***. I have ***\$242*** left over for debt repayment after basic living expenses. I would like you to accept a partial payment of ***\$50 per month for 34 months***, which will repay my obligation. You may expect the first payment on ***(month day, year)***.

Thank you.

Sincerely,

Your signature

Print your name

**NOTE:** The items in bold italics above should be changed to meet your situation.

