

Delivered From Debt

There are no quick fixes, but there are ways to gain control over bad credit spending habits.

Many years ago, I read in a financial self-help book that if I had a problem with credit-card spending, I should put the card in a bowl of water and freeze it. The idea was that it would be such a hassle to thaw it out, you'd have enough time to thoughtfully consider the purchase and avoid impulse buying.

Nice thought—in theory, that is. But here's a word of advice. If you have to thaw that card, don't put it in the microwave because it will (1) demagnetize the card and (2) melt the card into a misshapen mess.

Don't ask me how I know these things; I just did some, ah, research! Yes, that's it! I did research to discover these unusual facts in case you ever wanted to use plastic instead of paper money and you had all your credit cards on ice.

The best advice is to improve your financial health through plastic surgery—that is, by cutting up those cards.

My husband and I did it. We developed discipline through the spend-less,

save-more approach, and we're in a completely different financial place than we were when we lugged around \$40,000 in consumer debt.

The average consumer carries the largest percentage of his or her debt in credit cards—even more so than in a mortgage or car loan. You can cut spending in these areas, but the primary place most families need to look is at the thin piece of plastic in their wallets.

THE QUICK-FIX FANTASY

Your e-mail inbox is probably flooded daily with promises from the debt-consolidation industry that make claims such as “Debt relief is just a click away!”

Here are red flags that should go up when you consider consolidating your credit card bills:

Promises, promises. Some companies make claims that they will negotiate lower interest rates and reduce your monthly payments in one easy step. However, many of these debt consolidators build in a fee, usually 10 percent, as part of the monthly payment you make to them.

It's not worth paying someone else to do what you can do yourself. Go to the MSN Money Web site () and find out how to consolidate your debts.

Easy-does-it loan. Some consolidators

might entice you with the ease of obtaining a debt-consolidation loan but could end up charging you more interest than you're paying now. You might end up with lower payments, but you'll pay more over a longer period of time.

Balance-transfer trick. You might be drawn by offers for low-interest cards, but the low rates generally last only a few months. Then you have to switch cards again to find another low interest rate.

This activity is often negatively interpreted on your credit report. If and when the latest low-interest card will not approve you, you are left paying the higher interest on the card you are holding.

If you've already made such a switch, formally close the new accounts and ask the credit card company to mark the account "closed at the customer's request." Otherwise, it will appear that the creditor closed your account—which would make you look like a poor risk.

Decide right now that you will apply all extra monies to paying down this debt. Use all unexpected income—an inheritance, a tax refund, overtime pay, an employment bonus, a pay raise—toward debt reduction.

THE BEST MOVES These are a few of the best debt-consolidation options. Some of them may be a perfect fit for you:

Home-equity loan.

This is an obvious choice that should be used with great restraint. The primary advantage is that it tends to carry low interest rates, and the interest you pay is tax-deductible (check with your tax specialist yearly).

But you will have to pay an origination fee that ranges from \$75 to several hundred dollars, plus the cost of an appraisal and title insurance, so be sure it is worth it.

Refinancing a home.

In a “cash-out” refinancing option, the property owner refinances the entire loan for more than the property is worth and uses the extra cash to pay off credit cards. The primary disadvantage of this approach is that you are stretching your mortgage over 15 or 30 years.

The total interest cost can be pretty large, so you would need to keep two things in mind: (1) you would do this only once; and (2) you would concentrate on paying extra every month toward the principal, thereby shaving as much as a decade’s worth of interest off your loan.

Refinancing a car.

This is a secured loan, and you can borrow on it. But you need to

calculate whether you will run out of car before you run out of car debt. It's very difficult to buy a new car when you owe more than your present car is worth.

Negotiating terms. One of the easiest ways to lower your payments is to tell the credit-card company you want to consolidate your loans through another lending institution if you can't get the interest rate down on the card you currently have. Many customer service representatives are authorized to lower the interest rates right there on the phone for you, and you could save anywhere from several hundred to several thousand dollars.

Personal loans. This is an option only for those who have undamaged credit and who would qualify for an unsecured loan. The interest rates won't be as low as some of the other options, but they are usually less than the 20 percent-plus you are now paying the credit-card company.

The old standbys. For a qualified financial counselor, visit on the web Consumer Credit Counseling Services (CCCS). They are nationwide. Be sure you call the nonprofit organization and not a for-profit look-alike. These are different from the for-profit debt consolidation companies in that their services are free (and confidential).

Their initial consultation (by phone or in person) usually lasts an hour and will help you decide if you need a debt-management plan. To use their services, you must fill out a form that details all your expenses.

CCCS will walk you through the experience of seeing these stretched out over the course of a year. They will tell you if you can pay off your debt without their help.

FACE THE FACTS

A critical part of assessing your situation is to list pertinent information on columnar paper. You'll need to order a copy of your credit report from one of these national credit bureaus: Experian (, 1-888-397-3742); TransUnion Corp. (, 1-800-888-4213); or Equifax (, 1-800-685-1111). After you receive your report, use it as an information source for the following:

- * Creditors**
- * Balance on each account**
- * Minimum payment**
- * Number of payments left**
- * Interest rate**
- * Due date**

When this information has been documented in one place, it will be easier to ascertain your true debt load and develop a systematic plan to get out

of debt. This is something you can do at home or have CCCS do in their offices.

CUT COSTS The most effective thing you can do to resolve debt is reduce your committed expenses (housing, utilities, transportation, groceries, phone and so on). But for right now, focus on those monthly expenses that are not fixed.

It's not enough to cut costs if you're not committed to applying these savings to credit-card debt. The savings will just be absorbed into spending elsewhere unless you earmark these cuts to go to specific debt.

A more dramatic approach would be to reduce your fixed expenses by trading down in a home and/or car in order to get out of debt. This is an issue that you will need to decide based on your specific situation.

USE CREDIT RESPONSIBLY

You want a card that charges a low, fixed interest rate (not merely a temporary introductory rate) and has no annual fee. Don't be deceived by some of the "reward" cards. For example, most cards that offer frequent-flier miles require that you earn 25,000 miles (at one mile per dollar, \$25,000 spent) in order to buy one ticket (which averages \$250 to \$300).

For a list of credit cards by category (low-rate, no annual fee and others), go to or .

Other tools available to help you get the card that is right for you are
or .

PAY DOWN THE PRINCIPAL

My plan for debt reduction was based on solid principles and some of my great-grandma's common-sense strategies. Much of the best financial advice is on the Internet or compiled in inexpensive books.

You can follow some simple steps and watch your debts diminish. Here are a couple of strategies to pay down the principal rather than merely managing the interest:

Pay the original minimum on each credit entry.

If you continue to pay the amount of the original minimum payment, you will soon find that the required minimum is reduced. If your payment remains at the higher amount, you are paying on the principal and saving on interest by paying the debt off early.

Pay the least first or the most first.

Organize your debts in one of two ways. Put either the highest interest rate or the shortest payoff time as the top priorities on the list.

If all the payoff figures are close, pay the one with the highest interest rate. However, if you have a much smaller note at a lower interest

rate, going ahead and getting it paid off tends to serve as a morale booster. Then you can apply the total amount of that payment to the next bill on your list. For example, if you have a card on which you owe \$1,500 at 20 percent and another on which you owe only \$200 at 18 percent, go ahead and pay off the small debt first.

REBUILD GOOD CREDIT

A bankruptcy will stay on your credit report at least eight years. Even after you've rebuilt your credit, you won't be able to qualify for rock-bottom mortgage rates.

According to Jean Sherman Chatzky, financial editor at USA Weekend Magazine (January 21, 2000), these are the things that will have to be done to rebuild credit:

Close accounts you don't use. To lenders, charge accounts or home-equity lines of credit mean you could go on a spending spree at any time.

Don't hit all your credit limits. If you're using 80 percent or more of your available credit, it's a sign to lenders that you're overextended.

Limit inquiries into your credit record.

Minimize the number of times you apply for credit because each inquiry will appear on your credit report, whether you get the credit or not.

Keep in mind that all inquiries for one purpose, such as a mortgage, will count as one.

Don't miss payments. Automate as many payments as possible. If you make sure the funds are there, you will never be late on payments.

Hopefully,
you are motivated to get out there and hit the pavement!
Remember that
if a woman who has had \$40,000 of debt and freezes her credit
cards can
become debt free, so can you!

Ellie Kay

is an author, speaker and Family Financial Expert. Her books include A Woman's Guide to Family Finances and Shop, Save and Share (Bethany House). She and her husband, Bob, have seven children.