

Getting Out of Debt

Many people 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 take action against you in an effort to get payment. Or, your bill can be turned over to a debt collector. Your property can be repossessed. Wages may be assigned or garnished. You may be forced into bankruptcy.

However, several options may help you manage financial difficulties when bills stack up and you cannot pay them. You could set up a debt payment plan and discipline yourself to follow it. If that does not work, seek the assistance of a credit counseling service, or choose a court provision to handle your credit obligations.

The most desirable of these options is to set up a debt payment plan. If you need assistance in preparing the plan, contact a credit counseling agency. Many of these agencies are expanding their counseling services to include telephone and Internet counseling. The court provisions, which include bankruptcy, should be your last resort.

Developing a Debt Payment Plan

If you find yourself with more bills than your monthly income can cover, develop a debt payment plan. Once you develop the plan stick with it until all your debts are paid.

A debt payment plan will only work if you really want to get out of debt and are willing to start right now. Paying a little back is better than doing nothing or just worrying about the problem. Paying back a small amount will give you a sense of control. It will start you on your way to solving your financial problems.

To set up a debt payment plan, follow these steps:

1. Find out who you owe and how much you owe.
2. Decide how much you can pay back and when you can pay it back.
3. Set up a plan for paying back your debts.

4. Discuss your plan with your creditors.
5. Control your spending by sticking with your debt payment plan until 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.

Getting out of financial trouble is not easy. You have to admit that you have financial problems and really want to solve those problems. 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 borrowed.

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. So get out all of your credit statements. Use worksheet A and list the following information about each debt:

- Name of creditor.
- Creditor's telephone number.
- Your account number.
- Annual percentage rate (APR).
- Collateral (property such as your home, car, land, or other asset that secures any debt).
- 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 or repossession).
- Collection agency or attorney.

Decide How Much You Can Pay Back

Now you know who you owe. Figure out how much you can pay each creditor, and decide how long it will take to pay back each debt.

Generally, it is good to limit the amount of credit you owe (excluding your home mortgage) to no more than 20 percent of your monthly take-home

pay. If your family earns \$1,200 a month, try to keep your credit payments under \$240 per month ($\$1,200 \times 0.20 = \240). But if you already have numerous debts, figure out a way to use 25 percent of your monthly take-home pay to pay 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 ($\$1,200 \times 0.75 = \900) for basic living expenses. That leaves \$300 ($\$1,200 \times 0.25 = \300) for debt repayment. If the minimum monthly payments add up to \$396, you must try to increase your income. Several options may help you repay debts on a monthly basis.

Option 1. Keep a record of your current 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? Do you have a savings account or stocks and bonds you could cash in to help pay off your debts? Could you cash in or borrow against the cash value of your insurance policy?

Option 3. Increase your family income. An extra paycheck will help maintain your present lifestyle while you pay 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. Non-working family members could find jobs to help increase family income.
- If a family earner is disabled, disability insurance payments or workers' compensation might 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, and, by providing this service to others, you can increase family income. You also could trade your skills for a neighbor's skills. For example, you could provide child care in exchange for automobile repair services.

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 for borrowing is generally increased because the borrowing time is extended and 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. The use of these options generally does not improve poor money management habits and the reduced monthly payment may encourage you to acquire more debts.

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. Try to set up your plan so that you pay your creditors back within 3 years.

The actual debt payment plan can take several forms. The reduced payment method is to compute your reduced payments by calculating the percentage each individual debt represents of the total debt. To determine the percentage of total debt owed, divide each debt by the total debt owed as illustrated below.

This type of debt repayment plan applies to unsecured debt such as credit cards. You cannot include secured debt in these calculations. Lenders of secured credit require full payment on time or your property could be repossessed.

Reduced Payments Example. If you cannot make your full debt payments, you could pay back the percentage of total debt represented by each individual debt. Of course, the creditors would need to agree to this arrangement.

To determine the percentage of total debt owed, make the following calculation:

$$\frac{\text{amount owed}}{\text{total debt}} = \text{percentage of total owed}$$

$$\frac{\text{debt 1}}{\text{total debt}} = \frac{\$1,145.39}{\$3,380.69} = 0.34 \text{ or } 34\%$$

Debts	Amount owed	Percentage of total debt owed	Amount required	Amount you can pay
Bank card	\$1,145.39	34	\$180.00	\$102.00
Bank card	680.30	20	35.00	60.00
Personal loan	525.00	16	170.00	48.00
Retail card	755.00	22	190.00	66.00
Oil card	275.00	8	25.00	24.00
	\$3,380.69		\$600.00	\$300.00

To determine the amount you can pay, make this calculation:

$$\begin{array}{r} \text{total amount you can pay} \\ \text{X percentage of total debt owed} \\ \hline \text{amount you can pay} \\ \\ \$300.00 \\ \text{X } 0.34 \\ \hline \$102.00 \end{array}$$

Use Worksheet C to set up your debt payment plan. Write the creditor's name in the first column. Figure out the percentage of total debt owed each creditor and write it in the second column. Write the amount of the original monthly payment in the next column. Write the dollar amount you can pay each creditor each month in the fourth column. If the creditor accepts your plan, write the actual amount you will pay each creditor in the appropriate columns.

Once your income increases or some of your debts are paid, consider increasing your payments on remaining debts.

Inform Your Creditors

Now that you have worked out a plan, destroy all but one of your credit cards. Use it only for emergencies. Do not take out any more loans except in extreme emergencies, and contact each creditor and explain your plan. A sample letter to a creditor follows. Change the facts to fit your situation. Do not send the letter unless you intend to follow through with the repayment plan. Remember that creditors would rather receive a small payment than nothing at all. They also prefer to have the money than the items you purchased.

Use the format of the sample letter to write to each of your creditors. Explain to each creditor that you do not have the money to pay back the minimum payment that he or she has specified on the monthly statement. Be prepared to provide the following information to each creditor:

- Why you fell behind in your payments—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.

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. For additional information on loan consolidation, request "Managing Credit," Fact Sheet 435, from your county Extension office.

Credit Counseling Agencies

Sometimes it does not seem possible to manage the problem of being overextended financially. If you are unable to solve your financial problems alone, counseling agencies can help you set up a budget and a 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, and universities sometimes provide financial counseling.

Extension's Financial Counseling Service

Maryland Cooperative Extension has a Financial Counseling Service. Client families are assisted in debt management by trained volunteers. This free service is available in many counties.

Prioritizing Your Debts

When there is not enough money to make payments on all loans, prioritize your debts. Debts to pay first include mortgage or rent, utilities, secured loans, and insurance. Second priorities include unsecured debts to credit card and finance companies. Examples of third priorities might be your doctor, dentist, and hospital bills. Generally, family members and friends are willing to wait until you have solved your financial crisis.

The loan company can repossess your vehicle, whereas someone who has performed a service cannot take that service back. If there is not enough money to pay both bills, pay the loan company first, so you can keep your automobile. Put the service providers' bills on hold temporarily, but notify them of your plans and your intention to pay. If a creditor is threatening to garnish your wages, contact them immediately. Try to delay any action until a debt repayment plan is in place.

Although volunteer counselors are trained to look at the total financial picture, the primary purpose of counseling is to help families pay their bills on time. Most counselors use the PowerPay computer software to assist clients in developing a debt repayment plan. In addition, counselors help clients:

- set up a spending plan,
- contact creditors for adjustments in repayment,
- put financial records in order,
- review insurance coverage, and
- establish regular savings based on set goals.

Should unique problems arise, the volunteer counselors have access to county Extension educators, state Extension specialists, and financial consultants. To take advantage of this service, call your county Extension office.

Nonprofit Credit Counseling Agencies

Nonprofit credit counseling agencies help individuals or families with financial problems through budget and debt reduction planning. Typically, the agencies are supported by contributions from lenders such as banks, consumer finance companies, credit unions, and retailers. However, many charge a nominal fee to establish a debt repayment plan.

Anyone burdened by credit obligations can access counseling agencies. Clients may visit an office in person or make contact by phone or through the Internet. An application must be completed for a counselor to review. Then the counselor prepares a budget plan to be approved by the client and creditors. The budget plan outlines exactly how each debt will be repaid. The plan usually is all that is required unless there is an emergency or a change in a financial situation. Clients can return to the counseling service at any time for further advice. Participation in debt repayment programs may be noted in your credit report.

Court Provisions

The Federal Bankruptcy Code provides consumers with two forms of debtor relief. Chapter 7 of the code is the straight bankruptcy provision and provides for liquidation (conversion into cash) of the debtor's assets. Under Chapter 7, the secured creditors may have the security turned over to them unless the debtor reaffirms (accepts with the intention of paying) the debt with the court's approval. Maryland law allows the debtor to keep certain property and all other debts are discharged in bankruptcy. With bankruptcy under Chapter 7, you give up the property you put up for collateral when using credit unless the debts are reaffirmed by court permission and you continue to pay the creditor. Chapter 13 is the wage-earner's plan. With Chapter 13 you promise to pay existing debts with

part of the income you will earn in the next few years. While paying the debts, you will be able to keep the things you bought on credit if the courts approve your plan.

Chapter 7—Bankruptcy

Chapter 7 allows a person overburdened with debts to make a fresh start by discharging most of the creditor claims.

The granting of a discharge after the filing of a bankruptcy petition in Federal court releases or discharges you from the legal responsibility of your debts once the petition is approved. Once the petition is filed, garnishments and lawsuits can be stopped if proper papers are filed with the court; you are protected by the automatic stay provision of the Bankruptcy Code.

Your attorney will file the petition with the Clerk of the United States Bankruptcy Court in the area in which you have been living for the past 6 months. A filing fee must be paid. This fee is in addition to fees charged by your attorney for his or her services. You must file a list of all your debts and creditors. A detailed list of all property you own, money owed you, insurance policies owned, as well as property that may be inherited within 6 months must also be filed. You must list property for which you are claiming a homestead exemption. You also must file a detailed statement of your financial affairs.

Once the bankruptcy petition has been filed, the court will appoint a trustee. The trustee presides over the first meeting of creditors in the bankruptcy proceeding. The trustee also will liquidate certain assets that are not exempted or the debts reaffirmed, and these proceeds will be distributed to your creditors.

The bankruptcy court holds a hearing to inform you that your debts have been discharged or gives you a reason why they were not discharged. You may reaffirm certain debts with the court's approval if you desire to keep the collateral and if it is in your best interest. For instance, if you wish to keep your car, you can reaffirm the debt and continue to make payments. You do not have to reaffirm the debt; however, if you do, you become legally liable for the reaffirmed debt. The bankruptcy process takes a number of months from the date of filing until the date of discharge.

Bankruptcy claims may be voluntary or involuntary; most are voluntary. The only requirement for filing is that the debtor must owe one or more debts.

The following debts cannot be eliminated in bankruptcy:

- State and Federal taxes owed within the past 2 years before filing for bankruptcy.
- Money or items received by fraud or false pretenses.

- Unlisted debts, unless creditor had knowledge of bankruptcy filing.
- Child support or alimony.
- Debts incurred by embezzlement, fraud, or larceny.
- Willful or malicious injury to another person or person's property by the debtor.
- Government-imposed fines or penalties, such as tax penalties.
- Student loans guaranteed by the government or a nonprofit educational institution (except that if paying back the loan would cause undue hardship on the debtor or the debtor's dependents, or if the loan came due 5 years before filing for bankruptcy).

To pay back creditors, Maryland law exempts the following items from being released to the trustee for sale:

- Clothing (uniforms), books, tools, and instruments or appliances necessary for the practice of any trade or profession except those kept for sale, lease, or barter.
- Money payable in the event of sickness, accident, or injury, or death of any person, including compensation for loss of future earnings. Disability income is not exempt if the judgment is for necessities contracted for after the disability is incurred.
- Professionally prescribed health aids for the debtor or any dependent.
- The debtor's interest, not to exceed \$500 in value in household furnishings, household goods, clothing, appliances, books, animals kept as pets, and other items that are held primarily for the personal, family, or household use of the debtor or any dependents of the debtor.
- \$3,000 or property of any kind equivalent in value to \$3,000.
- \$4,500 in value of real property used as a residence if the debtor has attempted to negotiate a repayment schedule with his or her creditors.

Chapter 7 can be declared only every 6 years. However, if you get in financial trouble before the end of 6 years, you can file Chapter 13.

Chapter 13—Wage-Earner's Plan

Chapter 13 (the wage-earner's plan) is a voluntary repayment plan. When you complete the plan you have the satisfaction of keeping your assets, paying your creditors, and discharging your debts.

When filing Chapter 13 you agree to pay approximately 25 percent of your income to the court. The court appoints a trustee to handle your money and pay your debts. The trustee also provides advice and counsel when necessary.

To file Chapter 13, contact an attorney who has experience in filing Chapter 13 petitions. Next:

1. The attorney will file the petition with the Federal court. A court-appointed trustee is responsible for reviewing the petition, confirming the petition, paying the debts, and advising and counseling the debtor.
2. The court clerk will send notice of court action to creditors and the employer.
3. The employer sends a portion of your paycheck to the court trustee, who pays creditors. Secured debts are paid first, followed by unsecured debts.
4. The debtor cannot borrow more money without approval of the court trustee.

The actual amount of money paid creditors depends on the amount owed, the debtor's salary, and the payback time frame. Chapter 13 payment plans may not be proposed for longer than 36 months unless you can show reason for extending the plan. The maximum time allowed is 5 years.

Administrative costs may be high. They include the court costs, filing fee, the attorney's fee, and the trustee's fee for paying off the debts. The trustee also may receive a fee for expenses, such as typing equipment and supplies.

PowerPay Debt Reduction Computer Software

The PowerPay debt reduction-analysis computer program is an easy-to-use educational tool that enables consumers and financial advisors to quickly show the impact of power payments in individualized consumer debt situations.

- PowerPay first calculates what repayment time and interest costs will be if the consumer continues making payments at the current level.
- Next, PowerPay calculates the possible savings using three scenarios: 1) paying off creditors with the highest interest rates first, 2) paying off creditors with the lowest balance first, or 3) paying off creditors with the shortest term first.

PowerPay can also accommodate customized repayment plans, such as paying off a relative first or adding a monthly payment should extra funds become available. All this information is available on printouts and can involve as many as 30 creditors.

There are several advantages to filing Chapter 13, despite the expense. You do not lose your assets. The court protects you from wage garnishment and harassment. All debts are finally discharged.

It is possible to use credit after bankruptcy is filed. If credit is obtained after bankruptcy is filed, check your payments to make sure you are not making payments on debts discharged by bankruptcy. Some creditors might try to get you to pay back former debts. If both a husband and wife have signed contracts together, both will have to file for bankruptcy to discharge debts.

If you choose to file bankruptcy, you may harm your credit rating. Bankruptcy is shown on your credit file at the credit bureau for 10 years. In some cases, bankruptcy may be reported forever. This is the case if a credit report is supplied for a transaction involving a loan of \$150,000 or more; or if you are applying for a job at a salary of \$75,000 or more; or applying for a life insurance policy of \$150,000 or more.

Choosing an Attorney

If you choose to use Chapter 7 or Chapter 13, you will need to hire an attorney. Try to find an attorney who has experience in handling Chapter 7 if you choose to file bankruptcy. Choose an attorney who has experience in handling Chapter 13 if you choose to go that route. Some attorneys may handle Chapter 7 and know little about Chapter 13 and vice versa. Select your attorney carefully.

1. Ask friends or relatives if they know of an attorney who has handled Chapter 7 or Chapter 13.

2. Contact the bankruptcy judge's office in your area and ask for the names of several attorneys in your area who file Chapter 7 and Chapter 13 cases.
3. Call the Maryland Lawyer Referral Service sponsored by the State Bar of Maryland at this toll free number: 1-800-492-1964. Ask for the names of attorneys in your area who handle Chapter 7 and Chapter 13 cases.
4. Look in the Yellow Pages of your telephone book. After attorneys have been listed individually, they are listed by designated areas. Some attorneys designate family law, debtor law, taxation, or other specialties. Look to see if names are designated under consumer and debtor law.

Summary

When your debts are high and your monthly income is not enough to cover the payments, there are ways 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 above-mentioned counseling services.

Another way of settling your debts is by court provision. Your debts will be settled by selling your assets when filing bankruptcy. Under the wage-earner's plan (Chapter 13) you may keep your assets while paying back your debts.

The road to financial recovery takes a 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.

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Sample Letter

Street address
Your city, state, zip

XYZ Company
Street address
City, state, zip
Attention: Delinquent account representative

Subject: Your name
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
Your name

Worksheet B

Monthly Living Expenses

	Week 1	Week 2	Week 3	Week 4
Housing				
Mortgage payment or rent ...				
Insurance				
Utilities				
Gas, heating oil				
Electricity				
Water and sewage				
Telephone				
Trash collection				
Furnishings				
Maintenance and repairs				
Property taxes				
Food				
Groceries				
Meals eaten out				
Transportation				
Car payment				
Gasoline				
Insurance				
License/registration fees				
Maintenance and repairs				
Parking and tolls				
Rental, taxi, bus, subway				
Clothing				
Purchases				
Cleaning and laundry				
Alterations and repairs				
Medical				
Insurance				
Drugs and medicine				
Hospital				
Doctor				
Dentist				
Life/disability insurance				
Child care				

(continued on next page)

Worksheet B

Monthly Living Expenses (continued)

	Week 1	Week 2	Week 3	Week 4
Personal				
Books				
Magazines, newspapers				
Tuition, course fees				
Barber, hairdresser				
Toiletries and cosmetics				
Postage, stationery				
Recreation and entertainment .				
Movies, plays, concerts				
Cable TV				
Club dues				
Alcoholic beverages				
Tobacco				
Sporting goods				
Vacation				
Allowances				
Donations				
Gifts				
Birthdays				
Holidays				
All other				
Savings				
Credit payments				
Credit cards				
Student loans				
Home equity loans				
Other loans				
Miscellaneous				
Alimony, support payments . .				

Total				

