

## Getting Out of Debt

Getting out of debt is a long and difficult task. The first step to getting out of debt is getting organized when it comes to your finances.

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### Make a Plan

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Start by developing a budget. Taking control of your finances requires evaluating the money you are spending and bringing in. This means creating a solid budget that will allow you to pay your expenses, pay down your debt and save for your future.

To start, identify all of your income that you receive per month and make a list of your expenses. Write down all of the fixed expenses that do not change each month such as your mortgage, rent and car payments. Then, write down your variable expenses that vary from month to month such as groceries and entertainment. The next step is to prioritize your expenses in terms of necessity.

The goal is to identify essential expenses and make sure you are living within your means. Essential expenses are what you want to take care of first. They include housing, utilities, groceries, and transportation. Then, allocate funds for savings and debt payments. After this is done, you can dedicate the money that is left to lifestyle choices such as cable, cellphone plans, entertainment, restaurants, personal care, hobbies, and gym memberships.

Spending guidelines are a great resource that can help you determine how much money should be spent in each category. Compare your household budget with guidelines to identify any red flags of overspending and adjust your spending accordingly.

### Start an Emergency Fund

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Saving money in a savings account might sound counterintuitive when there is outstanding debt, but this is an essential step and will make paying down your debt easier. This fund is an insurance policy for any unexpected events which may occur. Having a buffer of essential expenses will allow you to focus on getting back on track instead of panicking if some unpredictable incident happens to occur. It is recommended to have approximately three to six months' worth of expenses in your emergency account.

### Contact Creditors

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It is important to communicate with your creditors before you fall behind on payments. Creditors are usually easier to work with when you let them know about your situation before a severe problem arises. Do not ignore any phone calls or mail correspondence from them. Inform them of the situation and attempt to work out a modified payment plan. You can also discuss any additional options which may be available.

Avoid being turned over to debt collection agencies. This would severely impact your credit score and in turn, inhibit your ability to borrow in the future. Being turned over may also result in legal action being taken against you. The better the relationship you build with your lenders, the more likely they are to work with you if you fall into financial hardship.

### Check Your Credit Score

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A credit score represents your reputation as a borrower. Lenders determine the risk of lending you money by your credit history and your credit score. The higher your credit score is, the more financing options you have. A good credit score is considered to be at 730 or above.

Knowing where you stand in terms of your financial options is vital. Options like consolidation, balance transfer, refinancing and any borrowing power are dictated by your creditworthiness. If you have good credit, you will have more options to attempt to get out of debt. If you have bad credit, your options may be much more limited.

### What to Pay Off First

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A lot of variables are involved in figuring out what debt to tackle first, but generally, you want to take into consideration which debt is costing you the most and how you can pay off the debt the quickest. Consider the following information to help you determine this:

- **Payday loans/high-interest loans:** Typically, these loans are meant to be short-term loans with extremely high-interest rates and severe penalties for missed payments. On average, the annual percentage rate (APR) start at 391%. It will be in your best interest to pay off these loans first because they are costing you the most.
- **Credit cards and auto loans:** These loans may also have high-interest rates, and depending on the balances, they can take a hefty chunk out of your monthly budget. You should pay off or eliminate as many monthly payments as possible. This way, you can dedicate that money toward other debt. Tackling high-interest rates will allow you to save more money on interest over the lifetime of the loan.
- **Car loans:** If you are unable to pay for your car, it might be in your best interest to just sell it or trade it in for something that is fully paid off to eliminate monthly payments. Because a car loan is a collateralized loan, it can be repossessed if you do not make payments. This will damage your credit score, and even though the car is no longer in your possession, you are still liable for the money you borrowed.
- **Student loans:** It is imperative to pay at least the minimum on your student loans each month. If you are unable to pay this, reach out to your lender and attempt to agree on an acceptable payment arrangement: forbearance or deferment. Student loans generally carry a lower interest rate and the paid interest is tax-deductible. You can deduct interest payments of up to \$2,500 per year. When you are ready to make additional payments on your student loans, start with the highest interest rate first.
- **Mortgage/equity loans:** These loans should be paid off last, provided you are making your monthly payments. They typically have the largest balances and tend to carry a lower fixed rate. You can make consistent payments toward these large debts as a long-term strategy and use additional disposable income toward other debts, savings or financial goals. Interest on your mortgage may also be tax-deductible.

Getting out of debt takes dedication and discipline. It is important to figure out your financial priorities and start a plan to become debt-free. If you are struggling in creating a plan, reach out to a professional credit counseling service.

## Tips

- **Spend less than you earn.** This will allow you to save money, pay down debt and achieve your financial goals.
- **Do not use credit cards.** Stop using them to get you to the next paycheck because this only puts yourself further in debt. Only use credit cards in a dire emergency.
- **Use a cash budget.** It is much more psychologically difficult to make purchases in cash in comparison to a credit or debit card.
- **Get your family involved and make sure everyone is on the same page.** Support from your loved ones can make a difference.
- **Stay positive** and praise your accomplishments.
- **Find tools and assistance that works for you.** Each individual has a unique connection to finances and not every option works for everyone.
- **Be patient.** Getting out of debt is a slow and difficult process.
- **Leave yourself some room.** You do not want to take drastic measures unless it is necessary. Completely changing your lifestyle is difficult, so reducing expenses might be more effective than eliminating them.
- **Consider your long-term goals and financial future.** Think about where you want to be five or ten years from now and focus on that.
- **Educate yourself on finances and various techniques.** If you know more, you can make better decisions for yourself and your family.
- **Try to pay more than the minimum.** This way, you are chipping away at the principle.
- **Think about every purchase you make,** whether it is a cup of coffee or a television. Be aware of where your money is going.

## Resources

- Federal Trade Commission: [www.consumer.ftc.gov](http://www.consumer.ftc.gov)
- MyMoney.gov: [www.mymoney.gov](http://www.mymoney.gov)
- How Stuff Works – Money: <http://money.howstuffworks.com>
- Financial Mentor - Budget Calculator: [www.financialmentor.com/calculator/budget-calculator](http://www.financialmentor.com/calculator/budget-calculator)

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