Tips! Managing Debt

Everyone can benefit from some tips on how to manage debt most effectively.

Statistics say that Canadian households are carrying more debt than at **any** other time in history. The need to effectively manage and reduce household debt can be further heightened during times of financial change (eg. job loss, death of a spouse, etc.). The following are some ideas on transitioning family debt management to work within a lower household income.

Practical steps to get out of/manage your debt

1. **Review your Financial Situation**
    a. **Review monthly expenses and find ways to save**

        Track expenses for a week and categorize every expenditure as either a need or a want. This will give you a realistic idea of where your family's finances are going and start to highlight some potential areas of reduction.

    b. **Use cash to separate needs from wants**

        Using cash to budget your expenses will get you to prioritize your needs from your wants. If one only has a limited amount of cash to spend, decisions are more likely to be based on needs.

    c. **Create a realistic spending plan**

        The goal with a spending plan is not to spend as little as possible, but to make a realistic plan which includes expenses you are likely to choose to create a balanced plan which is more likely to be followed.
        This link will help you create this spending plan http://www.mymoneycoach.ca/budgeting/budgeting-calculators-tools/budgeting-spreadsheet.

2. **Prioritize your Debt Payments**

    Make a list of your outstanding debts, including balances, interest rates and priority to your family needs. For example, your housing costs and utilities payments would be high priority items as their loss would result in a severe impact to you and your family. Once your list is prioritized, create your spending plan/budget for the money that is coming in.

3. Establish Realistic Goals for Managing/Paying off Debt

Establish realistic goals for paying off your credit card debt as well as other consumer debt (lines of credit, vehicle loans). Monitor your progress regularly to help you stay on track and motivated to reach your goals. The following are a mix of strategies on handling debt reduction.

Debt reduction strategies:

- **Snowball your payments to pay debt off faster**
  - After paying debts that are on fixed monthly payments (mortgages, vehicle and term loans), make the minimum payments required on your credit cards with the *lowest* interest rates and maximize your payments on the credit cards with the *highest* interest rates.
  - Once a debt is paid, use this extra money to pay down the credit card with *next highest* interest rate. This is sometimes called the snowball method to pay debt off, and it will save you money and help you pay down your debt faster.
- **Pay off credit cards or debts with small balances owing first**
  - Consider paying off credit cards with small balances first. Psychologically it shows that you are making progress.
  - Once paid, cut up and cancel the credit cards.

Use All Available Extra Money to Pay Debt Off Faster

- If you regularly contribute to a savings plan, consider suspending the payments until you have paid off your debt. The money you save by paying down your debt faster will be substantially higher than the interest you will earn in a savings plan.
- Also consider using income tax refunds, pay increases or other unexpected funds to pay down your debts.

Consider Your Debt Consolidation Options and Solutions

- Consider consolidating your debts into one loan with a fixed monthly payment or transferring your balances to a credit card with a low interest rate. Carefully investigate the terms, conditions and any hidden fees. Cut up and cancel your credit cards if you choose this option, otherwise you may be tempted to continue using your credit cards and further increase your debt load.
- There are many options to consolidate debt, so don't be afraid to ask for help if you need it. Most financial institutions will be willing to work with you on a plan if you are upfront and honest with them about the situation.

Type of Credit	Description	Approximate Interest Costs
Overdraft	• Attached to a chequing account. • Designed to cover items and avoid Non-Sufficient Funds charges	Around **17%**
Line of Credit	• Must qualify with a good credit history • Re-advanceable credit; only pay interest on what is owing	Around **1% to 3%** above the prime rate
Loan	• Specific borrowed amount to be paid back by regular payments over a set period of time • Credit history and collateral looked at for qualification and interest rate for a loan	Typically between **5% and 9%** Depends on credit history and whether debt is secured or not with collateral
Mortgage	• Loan for the purpose of purchasing property which is considered as the security for the loan. • Loan is amortized over long period; usually 25 years, and rates will depend on the market, credit history and the term selected.	Current rates around 3% Interests lower as the mortgage is secured by the real estate.
Home Equity Line of Credit	• This is a line of credit secured by the equity in your home. Typically lower interest rate; similar to good mortgage rates. • Only pay interest on amount owing.	Typically around **1% to 3%** above prime. Those with good credit history may qualify for lower rates.
Credit Cards	• Can pay minimum payment listed on bill. Helps to build credit history, but is an expensive form of credit and requires discipline to manage effectively. • Many cards offer reward programs to customers.	Typically **19% to 28%** If a reward program is included, weigh the costs and benefits as cheaper options may be available.
Credit Card Cheques	• Used as a payment method (like a regular cheque), but interest terms & rates are the same as for Cash advances on credit card	Interest rate usually the same as for purchases, but interest is charged on the balance from the time of purchase.
Buy now, Pay later	• "No payments till 2017" - offer a time of no payment, but if full amount not paid off by deadline, very high interest owing back to date of purchase	**28% to 40%** on balance owing from date of purchase.
Leasing	• Offered for vehicles, furniture, home electronics, etc. Lease amount is paid weekly/monthly for the length of contract. • May be a buyout fee as well at the end of the term.	**28% to 40%**
Finance Company	• Loans available with less strict qualification (ie. Easier to qualify for loans) required, but have high interest rates. Often these companies send out offers through bulk mail	**28% to 40%**
Payday Loans	• Short term loans based on income (pay day amounts). • Poor credit history is not a problem and cash is available quickly. • Payment is due when “paycheck” comes in.	Cost of borrowing can be as high as **300% to 1200%** annually
Pawn shops	• Cash is lent to the consumer based on the value of goods offered as collateral. Goods are held for 30 days before they can be sold. • If loan is repaid within the time frame (with associated interested), item is returned to the individual. • If not the item can be sold after an additional 15 day waiting period.	Starts at **30%**

Options to Discuss with Your Financial Institution

Depending on your debt instrument, some other options to discuss with your financial institution include:

- **Payment alterations** – changes to the frequency and/or the amount of regular payments.
- **Skip payments or Deferred payments** – most institutions will allow a customer to skip some of their regular payments and add them onto the end of the term. There will be limits in place on how many payments can be skipped *especially* if the debt is a Canadian Mortgage and Housing Corporation insured mortgage.
- **Longer amortization of lending to reduce monthly/regular payments** – this will result in more interest in the long run, but can help a family get control of their finances.
- **Interest Only payments** – Sometimes a financial institution will allow a customer to make payments on their lending equal to the interest payable on the loan. The customer then would make additional payments when finances were back on track, in order to "catch up".

There may be other options available to you, so it is vital to discuss the situation with your financial institution and get the best advice from their knowledgeable staff.

Sources of information:

Industry Canada – Contacting Creditors
Financial Consumer Agency of Canada – www.fcac-acfc.gc.ca
The Credit Counselling Society of BC – resources and articles at www.mymoneycoach.ca
Money Skills Financial Literacy program – click for details.