

Knee Deep in Debt

Having trouble paying your bills? Getting dunning notices from creditors? Are your accounts being turned over to debt collectors? Are you worried about losing your home or your car?

You're not alone. Many people face financial crises at some time in their lives. Those just starting out on a career may be weighed down by student loans and credit-card debts that were run up in college. Generation Xers might get in over their heads with car and house payments or debts from a spell of unemployment. Baby boomers and older workers may get swamped by medical bills—a common reason for bankruptcy—if their insurance is nonexistent or inadequate. Whether the crisis is caused by personal or family illness, the loss of a job or simple overspending, it can seem overwhelming, but often can be overcome. The fact of the matter is that your financial situation doesn't have to go from bad to worse.

If you or someone you know is in financial hot water, consider these options: realistic budgeting, credit counseling from a reputable organization, debt consolidation or bankruptcy. How do you know which will work best for you? It depends on your level of debt, your level of discipline and your prospects for the future.

Self-help

Developing a budget: The first step toward taking control of your financial situation is to do a realistic assessment of how much money comes in and how much money you spend. Start by listing your income from all sources. Then, list your "fixed" expenses—those that are the same each month—such as your mortgage payments or your rent, car payments or insurance premiums.

Next, list the expenses that vary, such as entertainment, recreation or clothing. Writing down all your expenses—even those that seem insignificant—is a helpful way to track your spending patterns, identify the expenses that are necessary, and prioritize the rest. The goal is to make sure you can make ends meet on the basics: housing, food, health care, insurance and education. Just what is essential, and how much you should budget for each category depends in part on your situation, age and priorities. Education is a big expense for those with college-age children (or those still in college and graduate school). Insurance—life and disability as well as auto—is a significant need for workers who have dependent children. Health care costs tend to be higher as one ages. In any case, it is crucial to know exactly how you have been spending your money over the past year or so before you can decide how much you will need to spend—and how much you can afford to cut—going forward.

Your public library has information about budgeting and money management techniques. Low-cost budget counseling services that can help you analyze your income and expenses and develop budget and spending plans also are available in most communities. Check your Yellow Pages or contact your local bank or consumer

protection office for information about them. In addition, many universities, military bases, credit unions, and housing authorities operate nonprofit counseling programs.

Contacting your creditors: Contact your creditors immediately if you are having trouble making ends meet. Tell them why it's difficult for you, and try to work out a modified payment plan that reduces your payments to a more manageable level. Don't wait until your accounts have been turned over to a debt collector. At that point, the creditors have given up on you.

Dealing with debt collectors: The Fair Debt Collection Practices Act is the federal law that dictates how and when a debt collector may contact you. A debt collector may not call you before 8 a.m., after 9 p.m., or at work if the collector knows that your employer doesn't approve of the calls. Collectors may not harass you, make false statements or use unfair practices when they try to collect a debt. Debt collectors must honor a written request from you to cease further contact.

Credit counseling: If you aren't disciplined enough to create a workable budget and stick to it, can't work out a repayment plan with your creditors, or can't keep track of mounting bills, consider contacting a credit counseling service. Your creditors may be willing to accept reduced payments if you enter a debt repayment plan with a reputable organization. In these plans, you deposit money each month with the credit counseling service. Your deposits are used to pay your creditors according to a payment schedule developed by the counselor. As part of the repayment plan, you may have to agree not to apply for-or use-any additional credit while you're participating in the program.

A successful repayment plan requires you to make regular, timely payments, and could take 48 months or longer to complete. Ask the credit counseling service for an estimate of the time it will take to complete the plan. Some credit counseling services charge little or nothing for managing the plan; others charge a monthly fee that could add up to a significant charge over time. Some credit counseling services are funded, in part, by contributions from creditors.

While a debt repayment plan can eliminate much of the stress that comes from dealing with creditors and overdue bills, it does not mean you can forget about your debts. You still are responsible for paying any creditors whose debts are not included in the plan. You are responsible for reviewing monthly statements from your creditors to make sure your payments have been received. If your repayment plan depends on your creditors agreeing to lower or eliminate interest and finance charges, or waive late fees, you are responsible for making sure these concessions are reflected on your statements.

A debt repayment plan does not erase your credit history. Under the Fair Credit Reporting Act, accurate information about your accounts can stay on your credit report for up to seven years. In addition, your creditors will continue to report information about accounts that are handled through a debt repayment plan. For example, creditors may report that an account is in financial counseling, that payments may have been late or missed altogether, or that there are write-offs or other concessions. A demonstrated

pattern of timely payments will help you obtain credit in the future.

Auto and home loans: Debt repayment plans usually cover unsecured debt. Your auto and home loan, which are considered secured debt, may not be included. You must continue to make payments to these creditors directly.

Most automobile financing agreements allow a creditor to repossess your car any time you're in default. No notice is required. If your car is repossessed, you may have to pay the full balance due on the loan, as well as towing and storage costs, to get it back. If you can't do this, the creditor may sell the car. If you see default approaching, you may be better off selling the car yourself and paying off the debt: You would avoid the added costs of repossession and a negative entry on your credit report.

If you fall behind on your mortgage, contact your lender immediately to avoid foreclosure. Most lenders are willing to work with you if they believe you're acting in good faith and the situation is temporary. Some lenders may reduce or suspend your payments for a short time. When you resume regular payments, though, you may have to pay an additional amount toward the past due total. Other lenders may agree to change the terms of the mortgage by extending the repayment period to reduce the monthly debt. Ask whether additional fees would be assessed for these changes, and calculate how much they total in the long term.

If you and your lender cannot work out a plan, contact a housing counseling agency. Some agencies limit their counseling services to homeowners with FHA mortgages, but many offer free help to any homeowner who's having trouble making mortgage payments. Call the local office of the Department of Housing and Urban Development or the housing authority in your state, city, or county for help in finding a housing counseling agency near you.

Debt consolidation: You may be able to lower your cost of credit by consolidating your debt through a second mortgage or a home equity line of credit. Think carefully before taking this on. These loans require your home as collateral. If you can't make the payments—or if the payments are late—you could lose your home.

The costs of these consolidation loans can add up. In addition to interest on the loan, you pay "points." Typically, one point is equal to one percent of the amount you borrow. Still, these loans may provide certain tax advantages that are not available with other kinds of credit.

Bankruptcy: Personal bankruptcy generally is considered the debt management option of last resort because the results are long-lasting and far-reaching. A bankruptcy stays on your credit report for 10 years, making it difficult to acquire credit, buy a home, get life insurance or sometimes get a job. However, it is a legal procedure that offers a fresh start for people who can't satisfy their debts. Individuals who follow the bankruptcy rules receive a discharge—a court order that says they do not have to repay certain debts.

There are two primary types of personal bankruptcy: Chapter 13 and Chapter 7. Each must be filed in federal bankruptcy court. The filing fees run about \$185 for Chapter 13 and \$200 for Chapter 7. Attorney fees are additional and can vary

Chapter 13 allows persons with a steady income to keep property, like a mortgaged house or a car, that they otherwise might lose. In Chapter 13, the court approves a repayment plan that allows you to use your future income to pay off a default during a three-to-five-year period, rather than surrender any property. After you have made all payments under the plan, you receive a discharge of your debts.

Known as straight bankruptcy, Chapter 7 involves liquidation of all assets that are not exempt. Exempt property may include automobiles, work-related tools and basic household furnishings. Some of your property may be sold by a court-appointed official—a trustee—or turned over to your creditors. You can receive a discharge of your debts through Chapter 7 only once every six years.

Both types of bankruptcy may get rid of unsecured debts and stop foreclosures, repossessions, garnishments, utility shut-offs and debt collection activities. Both also provide exemptions that allow people to keep certain assets, although exemption amounts vary. Note that personal bankruptcy usually does not erase child support, alimony, fines, taxes, and some student loan obligations. And unless you have an acceptable plan to catch up on your debt under Chapter 13, bankruptcy usually does not allow you to keep property when your creditor has an unpaid mortgage or lien on it.

Damage control

Turning to a business that offers help in solving debt problems may seem like a reasonable solution when your bills become unmanageable. Be cautious. Before you do business with any company, check it out with your local consumer protection agency or the Better Business Bureau in the company's location.

Some businesses that offer debt counseling and reorganization plans may charge high fees and fail to follow through on the services they sell. Others may misrepresent the terms of a debt consolidation loan, failing either to explain certain costs or to mention that you're signing over your home as collateral. Businesses advertising voluntary debt reorganization plans may not explain that the plan is a Chapter 13 bankruptcy, tell you everything that's involved, or help you through what can be a complex and lengthy legal process.

In addition, some companies guarantee you a loan if you pay a fee in advance. The fee may range from \$100 to several hundred dollars. Resist the temptation to follow up on advance-fee loan guarantees. They may be illegal. Many legitimate creditors offer extensions of credit through telemarketing and require an application or appraisal fee in advance. But legitimate creditors never guarantee that the consumer will get the loan or even represent that it is likely. Under the federal Telemarketing Sales Rule, a seller or telemarketer who guarantees or represents a high likelihood of your getting a loan or some other extension of credit may not ask for or receive payment until you've received

the loan.

You should also avoid credit repair clinics. Companies coast to coast appeal to consumers with poor credit histories, promising to clean up credit reports for a fee. They don't deliver. What's more, they can't deliver: They can't do anything for you that you can't do for yourself. After you pay them hundreds—or even thousands—of dollars in up-front fees, they can do nothing to improve your credit report. Indeed, many simply vanish with your money. Only time and a conscientious effort to repay your debts will improve your credit report.

If you're thinking about getting help to stabilize your financial situation, be cautious:

- Find out what services the business provides and what it costs.
- Don't rely on oral promises. Get everything in writing.
- Check out any company with your local consumer protection office and the Better Business Bureau in the company's location. They may be able to tell you whether other consumers have registered complaints about the business.

Source: Adapted from the Federal Trade Commission,
<http://www.ftc.gov/bcp/online/pubs/credit/kneedeep.htm>