

# In Over Your Head

Life-Saving Strategies  
for Financial Crisis



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## **Disclaimer:**

This booklet is intended to provide education and information. This document is not meant to provide legal advice or to be used in the practice of law. The reader is encouraged to use his or her own judgment in making competent financial decisions and to seek the judgment and skills of competent legal counsel.

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# First Steps

Unemployment, illness, family problems, and careless spending, as well as many other issues, can lead to a situation where you can't pay your bills. As unpaid bills mount up, the total amount of your debt can overwhelm you. If you answer yes to most of the questions below, you are "in over your head" in debt. You may have to take some lifesaving financial actions.

## Are you in over your head?

- Do you feel overwhelmed by your bills?
- Are you making minimum or less than minimum payments on your accounts?
- Are calls and letters from bill collectors driving you crazy?
- Are you throwing unopened bills into a pile?
- Are you using cash advances from your credit card or check cashing services to pay your everyday bills?
- Are you unable to pay your new monthly charges?
- Is your debt level, not including the mortgage payment, over 20 percent of your take-home pay?
- Have you lost track of how much money you owe and to whom you owe it?
- Would an emergency, such as having your work hours cut, result in a financial catastrophe?
- Is your stress level rising?

## Lifesaving actions

The most important things to do at this point are:

1. Admit you have a problem.
2. Discuss the problem with your family. Call an emergency meeting and explain the situation. Everyone will have to pull together to get out of "deep water." It won't be easy to say, "We can't afford to do ...." or "We don't have the money to buy ...."
3. Stop spending! Limit spending to items basic to survival, such as food, shelter, and essential medical treatment.
4. Stop using your credit cards. Consider cutting up some cards to reduce temptation to use credit. Remember, cutting up cards doesn't eliminate the debt nor does it close the account. If you decide to save one card to use in case of an extreme emergency, freeze it in a bowl of water so it is not readily available. In choosing which card to keep, consider one with a low Annual Percentage Rate (APR) that can be used anywhere, such as VISA or MasterCard, and one you have had for the longest time.
5. Return unused items you have purchased for which you can receive a full refund. Apply the refund to your debts.
6. Sell items you can live without and apply the money toward your debt. Consider a garage sale, a consignment shop, or an online selling service.

7. If you can't sell an item for the amount owed, consider allowing it to be repossessed. This action may be reported to a credit bureau and remain on your credit report for up to seven years.
8. Find an evening or weekend job or accept more overtime work.
9. Cancel overdraft protection on your checking account. Don't write checks that exceed the balance in your account.
10. Your credit history has been tracked by three major Credit Reporting Agencies: Experian, Equifax, and TransUnion. Your credit report includes debt repayment history, total debt, employment, and residence information. You are entitled to one free credit report each year from each of these agencies. Go to **www.annualcreditreport.com** or call 1-877-322-8228. Since every creditor does not report to every credit bureau, you need records from each to have a complete credit record. Therefore, experts recommend staggering your requests to the three agencies throughout the year to monitor the information. Be sure your credit report is accurate. If there are errors, follow the instructions included with the report to have the errors corrected.
11. Open all mail from creditors and read the statements carefully. The Know What You Owe forms (pages 7–9) will help you understand your current financial situation and will compile your debt information in one place. Record the name, address, and phone number of each creditor; the amount you owe; the amount past due; the minimum monthly payment; and the APR of interest you are paying on the balance.
12. Contact creditors. Do not ignore bills or other communication. Explain the situation and send them a written summary of what actions you are taking to deal with your debt. Tell them when they can expect payment and how much you will be able to pay on a regular basis. Don't promise what you can't deliver. Keep a copy of all letters. Keep a record of calls to and from creditors. Record the time, date, the name of the person you spoke with, and details of the conversation.

## Consider your options

This *In Over Your Head* booklet can help you consider your options.

- **Section 2: Dealing with debt and debt collectors—page 11**
- **Section 3: Self-directed repayment plans—page 15**
- **Section 4: Credit counseling services—page 21**
- **Section 5: Consolidation and other repayment strategies—page 24**
- **Section 6: Bankruptcy—page 27**
- **Section 7: Coming up for air—page 35**

On the following pages are Know What You Owe forms. These forms will help you collect information about your debt.

Know what you owe: **secured debt** (See page 10 for definition)

List of creditors (from largest to smallest)	Item(s) purchased	Total balance owed	Monthly payment	Payment due date	APR (Annual Percentage Rate)	Equity (amount already paid)	Total past due	Months behind in payment
Company Address								
Phone Account #								
Company Address								
Phone Account #								
Company Address								
Phone Account #								
Company Address								
Phone Account #								
Totals:								

Know what you owe: **unsecured debt** (page 10 for definition)

List of creditors (from largest to smallest)	Total owed	Minimum monthly payment	Due date	Annual Percentage Rate of Interest and calculation method*	Credit limit	Total past due	Service charges and other fees	"X" if sent to a collector
Company Address Phone Account #								
Company Address Phone Account #								
Company Address Phone Account #								
Company Address Phone Account #								
Company Address Phone Account #								

Know what you owe: **unsecured debt** (continued)

Company Address																				
Phone Account #																				
Company Address																				
Phone Account #																				
Company Address																				
Phone Account #																				
Company Address																				
Phone Account #																				
Company Address																				
Phone Account #																				
Totals:																				

\*Monthly interest is calculated on the balance owed. The "balance" is determined in one of three different ways: (1) Adjusted balance; (2) Average daily balance; (3) Previous balance. Listed from least expensive to most expensive—(1) is least expensive method of calculation and (3) is the most expensive method.

## Company address and phone number

When listing your creditor's address and phone number, check the statement you receive or the original credit contract for the correct information. The address you send your payment to is not necessarily the same address you would write to if you can't make a payment or have a problem with your bill. Also check for the correct phone number. If your account has been sent to a bill collector or debt collector, the address and phone number are different from those listed on your account statement. Make sure you are contacting the correct party when trying to negotiate a new interest rate or make other payment arrangements.

## Secured and unsecured debt

Secured debt is "backed" by collateral. Collateral is the property a creditor has the right to seize if you do not pay a debt. The most common forms of collateral include your home, a car, or household goods. When a creditor has collateral for your loan, the creditor has a "lien" on your property. Creditors who have security can repossess the collateral and sell it to get their money. This kind of loan is referred to as a secured loan. Loans without collateral are called "unsecured" loans. It is usually more difficult for a creditor to collect an unsecured debt.

## Annual Percentage Rate of interest (APR)

Interest is the money you pay to the lender for the privilege of using the lender's money. The APR may be different from the stated interest rate because it includes the full cost of the loan, which may include fees or other charges. The APR tells you the true cost of the loan. You will find the initial APR on the disclosure statement you were given when you signed papers for the loan or on the disclosure statement that came with your credit card application. The APR may be changed by a creditor because of the way you have managed your credit with them or other creditors. Check the bill for the current rate.

## Equity

Equity is the amount you have already paid on the principle of a loan. This amount reflects the "equity" you have in the property.

Once you have completed the twelve steps listed in this first section you will be better prepared to choose your course of action. The following sections provide information on how to deal with debt collectors and the various options to consider for dealing with your debt.

## References

Leonard, Robin. *Money Troubles: Legal Strategies to Cope with Your Debts*. Berkeley, CA: Nolo, 2003.

Loonin, Deanne. *Guide to Surviving Debt*. Boston, MA: National Consumer Law Center, 2008.

Seiling, Sharon B., and Carolyn McKinney. *Know What You Owe*. Revised by Diane Johnson. Columbus: Ohio State University Extension, 2000.

Tyson, Eric. *Personal Finance for Dummies*. 5th ed. Indianapolis: Wiley, 2006.

# Dealing with Debt and Debt Collectors

When you are behind in paying your bills, you may be contacted by debt collectors.

What you can do before collectors start calling:

- When you must delay paying a bill, contact the creditor and explain the situation. Don't wait until you get your creditor's attention by missing a payment. Explain the facts of your situation and that you must pay your mortgage, utilities, and certain other expenses before paying this particular bill. Let the creditor know that you have not forgotten this debt and you will pay when you can. Ask if minimum monthly payments can be reduced or if an interest-only payment is possible. Creditors may be willing to accept a lower monthly payment if they know that it will be paid on a regular basis. Do not promise to make payments that you cannot afford. Be sure you

can follow through and honor the commitment you are making. Be honest about your expectations for future income. Send the creditor a letter to confirm your repayment plan. See the example below.

## Sample letter to creditors:

*Your name*  
*Your address*  
*Your phone*  
*Account #:*

Date

*Creditor name*  
*Creditor address*

Dear XXX:

Thank you for talking with me today about my account. As we discussed, I lost my job due to my company's closing. I am looking for another job. Until I find a new job, which I hope will be within six months, you and I agreed to the following repayment plan: \_\_\_\_\_ (*for example*)

My credit privileges are suspended until I find another job.

During this time of unemployment, I am required to pay the monthly interest charges on my outstanding balance but do not need to pay on the principle.

You will call throughout the six months to check on my employment progress.

I will begin making full payments the month after I return to work.

You agreed to sign a copy of this letter and return it to me to verify the agreement.

I have enclosed check #XXXX in the amount of \$XX.XX to cover the one month's interest charge that is in arrears. My suspended credit card is also enclosed.

Thank you very much for your understanding and assistance with this matter.

Sincerely,

*Your name signed*  
*Your name typed*

- If the creditor threatens to turn the debt over to a collector, make sure the creditor knows you will not be able to pay a collection agency any sooner. Since creditors must pay collection agencies either a fee per debtor or a percentage of the amount recovered, it is to their advantage not to send a bill to a collector. Try to convince your creditor to wait until your situation gets better.
- Examine all credit contracts. Pay on high-interest rate debt before lower-rate loans. Will you be charged late fees? Will these put you over your credit limit and cause you to be charged additional fees plus interest on these additional fees? Contact these creditors to try to make some adjustments. Don't wait until the original creditor sends a debt to a collector. Collectors don't negotiate readily.
- Determine which of your debts are secured and which are unsecured (see the Know What You Owe forms on pages 7–9). A secured creditor can repossess the property that secures the debt. A landlord can evict you, a mortgage holder can take property that is mortgaged, and a utility company can cut off service. Unsecured loans don't have property that can be repossessed. An unsecured creditor can do three things if you don't pay the debt: stop doing business with you, report your default to a credit reporting agency, or bring a lawsuit to collect debt. These creditors can turn your account over to their own collection department or an outside agency (also known as a third party collector). Don't convert a low-interest unsecured loan to a secured one by taking a line-of-credit, mortgage, or consolidation loan that requires collateral. You run the risk of losing the property if you can't make the payments.
- If you fall behind on your car payments, the creditor is allowed to repossess your car, without notice. If your car is repossessed, you will still owe the full balance due on the loan as well as towing and storage costs. If you can't pay the balance, the creditor may sell the car. If the car is sold for less than the amount you owe, you will be required to pay income tax on the difference. If the debt is forgiven, you will receive an IRS form 1099 identifying the forgiven amount that will be considered taxable. If you think you might default, you may be better off trying to sell the vehicle yourself to pay off the debt. By doing so, you can

avoid the costs of repossession and a negative entry on your credit report.

- Contact your home mortgage lender as soon as possible to avoid foreclosure on your home. If lenders feel you are acting in good faith and the situation is temporary, most are willing to work with you. They may allow you to reduce or suspend your payments for a short time. However, when you begin making regular payments, you may have to pay an additional amount to catch up the overdue amount. Some lenders may consider changing the terms of the mortgage by extending the repayment period. This will reduce the monthly payments. Find out what fees are charged for these changes.

## What to expect from debt collectors

- Whether your debt is collected by the original lender or is turned over to an outside collection agency, you can expect an aggressive campaign to get your attention. The collector's tools include letters and phone calls with suggestions on how you can pay the debt in full.
- Do not let the pressure of these contacts cause you to pay even a small amount on low priority bills if it means you can't meet high priority expenses such as mortgage, utilities, or food.
- Debt collectors may pressure you to borrow from a loan company, other credit cards, or relatives to pay your debt to them. Sections 3, 4, and 5 provide information about other options that may be much better than suggestions made by debt collectors.
- Sometimes collectors will try to convince you to send them postdated checks to cover the full amount. Don't do this. You may not have money in your account to cover these checks. If you write a check without sufficient funds, you will be charged a hefty fee.
- A collector from a collection agency who makes veiled threats to do anything except stop doing business with you, report a default to a credit bureau, or sue for the unsecured debt is using deceptive practices and is in violation of federal law. You can obtain information on the Fair Debt Collection Practices Act (FDCPA) or contact the Federal Trade Commission, Bureau of Consumer Protection for more information (<http://www.ftc.gov/bcp/index.shtml>).

- A collector may threaten to ruin your credit report. Most creditors who report to a credit bureau do so monthly by computer. So by the time a collector gets involved, your credit report will already show that you are 30, 60, 90, or more days behind in paying your bills. Negative information the collector could place in your file is probably already there.

Collectors sometimes threaten to take actions that are clearly violations of the FDCPA. You should know:

- They cannot send you to jail, seize your wages without a court judgment, or threaten your children.
- Collectors cannot publish your name or talk to a third party such as neighbors, relatives, friends, or an employer unless you or the court have given permission. They can, however, talk to a spouse, an attorney, a creditor, credit reporting agencies, a co-signer, or a parent if you are a minor.
- A collector may not call you at unusually early or late times (before 8 a.m. or after 9 p.m.) or at your workplace to harass you.
- Collectors cannot use obscene or insulting language, make false threats, or engage in any other forms of deceptive conduct or unfair harassment.

## Stopping harassment

- The simplest way to stop collectors from harassing you is to write a letter requesting that they stop collection contacts. (This is called a cease letter; see the example on page 14.) In this letter, outline the objectionable behavior of the collector's employees. Keep a copy of the letter for later reference.

Be aware, however, that federal law does not apply to creditors who are collecting their own debts. Frequently, when a creditor receives such a letter, they will honor the request. Keep in mind that under the FDCPA, a debt collector must stop all communications except to tell you collection efforts have stopped or that a specific remedy is being invoked against you, such as filing suit. However, this does not make your debt disappear. Collection efforts can continue using legal means. Only the harassment stops.

- Some consumers seek help from an attorney when they are being hounded by collectors. If your cease letter is not effective, then perhaps one from

an attorney might be. As long as your attorney responds to a collection agency's inquiries, the agency must stop contacting you. Most of the time a simple cease letter will accomplish this without added attorney's fees.

- Another way to stop harassment is to work out a payment plan. When collectors finally know that payment will not be made in full, they may be willing to work out a payment plan with you or a credit counseling agency. Be careful not to agree to a payment plan that will interfere with meeting your high-priority obligations. It is not in your best interest to make small payments on an unsecured debt if it means you can't make payments on a secured debt.
- Bankruptcy is another way to stop collection activity. Filing the initial papers triggers an automatic stay. This means all collections, whether from a creditor or a collection agency, must stop unless permission is granted to a creditor from the bankruptcy court. The court will not give this permission for unsecured debt. Bankruptcy should be reserved for serious financial problems. (See section 6 of this booklet for more information.) If your only problem is harassment by collectors, the other remedies listed should be used first.
- An additional strategy for stopping harassment is to write a letter of complaint to the Federal Trade Commission, Bureau of Consumer Protection, Washington, D.C. 20580. Send copies to your state attorney general's office of consumer affairs, and the local Better Business Bureau. Be certain that you outline any way that the collector harassed you. Send a copy to the collector as well. Although an investigation by these agencies is unlikely for one case, your letter, along with complaints of others, could lead to government action.

## References

Detweiler, Gerri. *The Ultimate Credit Handbook: How to Cut Your Debt and Have a Lifetime of Good Credit*. 3rd ed. San Francisco: Plume, 2003.

Leonard, Robin. *Money Troubles: Legal Strategies to Cope with Your Debts*. 9th ed. Berkeley, CA: Nolo, 2003.

Leonard, Robin, and John C. Lamb. *Solve Your Money Troubles: Get Debt Collectors Off Your Back and Regain Financial Freedom*. 11th ed. Berkeley, CA: Nolo, 2007.

Richards, Chris J. *Debt Control: How to Get Out of Debt and Stay Out of Debt*. Houston, TX: Emerald Ink Publishing, 2005.

## Sample cease letter:

**Date:**

**Name and address  
of collection agency:**

**Attention:**  
*(name of person in charge of account):*

**Re: Account #**

**Dear \_\_\_\_\_,**

**This is to confirm our phone conversation on \_\_\_\_\_ (list date) regarding the account listed above. In accordance with the Fair Debt Collection Practices Act, Section 805 (c), this letter is your notification to “Cease and Desist” any further communication concerning the above mentioned debt.**

*(If there are specific harassment complaints, list them here.)*

**Your failure to comply with this request will result in charges against your company and any employee attempting to collect this debt.**

**I will appreciate your immediate cooperation.**

**Sincerely,**

**Your signature:**

**Your printed name:**

**Your address:**

***Send this letter via certified mail with a return receipt.***

# Self-Directed Repayment Plans

It may be possible for you to develop your own debt repayment plan. It will require:

- self-discipline
- a down-sized budget (page 16)
- knowledge of a simple debt reduction technique known as “power payments”
- taking on no new debt
- time to carry out the plan successfully! It may in fact take several years to get out of debt.

In addition to the above, other factors may help you decide the order in which debts will be paid. To pay the least possible amount of interest, list debts in order of those with the highest interest rates to the one with the lowest rate. If it will be more satisfying and motivating for you to see debts paid and crossed off your list, then list them from the debt with the smallest dollar amount to the largest amount owed. Remember that you may pay more total interest paying debts in this order.

Here are steps to help you develop your repayment plan:

- Step 1. Stop all unnecessary spending and develop a down-sized budget (page 16). Necessary spending includes food, shelter, and essential medical treatment. Discuss finances with your family and have each member develop a personal action plan to help keep expenses to a minimum.
- Step 2. If you have pre-authorized monthly direct payments or money transfers, examine them and choose the ones you need to continue. These might include mortgage, car and other loan payments, and insurance premiums. Are there any that you should discontinue?
- Step 3. Use your completed Know What You Owe Worksheet (pages 7–9) to prioritize your debts. Decide which bills to pay first and which to delay. Remember, however, you are obligated to pay all debts. Consider the consequences

of not paying each debt. Could you lose your home, your car (if you need the car), or other possessions? Could your utilities be disconnected? You may consider the following priorities:

High priority: housing, essential utilities, car loans or leases and necessary insurance (if you really need the car), child support, and taxes.

Medium priority: loans with collateral and student loans.

Low priority: credit cards, doctor’s bills, loans without collateral, and rent-to-own contracts.

Step 4. Down-size your budget to make money available for payments on your debts. (Use the budget worksheets on pages 16–17). How much do you need for basic living expenses? If you have never developed a written spending plan before, you will definitely need one now. There are resources available from your Extension office and at <http://www.extension.org>.

Step 5. If you have money left, then you are well prepared to go to the next step in developing a debt repayment plan. If your basic expenses and your debt payments are more than your income, you are going to have to take some action before you can develop a plan to eliminate your debt.

Go over your down-sized budget and look for ways you could cut back on flexible or unnecessary expenses. Any amount of money that you are able to cut back can be used for debt repayment.

Your budget plan should reflect the cutbacks and reduced minimum payments you have negotiated with creditors. Your expenses plus minimum payments on all your debt should be less than your income. If they are not, you should explore other options explained in this booklet.

Continued on page 18

## Down-sized monthly budget

This budget worksheet is designed for people like you—people who are deep in debt and must make tough choices about their money use. You will notice that there are no spaces for entertainment, gifts, pets, or other things that make life more comfortable

Develop a spending plan to meet your minimum needs using a down-sized monthly budget. Take the following steps to work out your new spending plan.

1. Estimate your monthly take-home income. Include earned income, interest, dividends, pensions, and child support.
2. Estimate your fixed expenses. These are expenses that are the same every month. They normally include things such as: rent or mortgage, utilities (only those you need), debt payments (include minimum payments on all debts), child support, car insurance, and necessary medical expenses.
3. Calculate the amount you need to spend on necessary but flexible expenses each month. These include food, transportation, basic household operation, and essential personal needs.
4. Estimate the necessary expenses that will arise occasionally during the next year. These might include vehicle license plates, car maintenance and repairs, medical care, clothing for children, and basic school expenses. Total these expenses and divide the amount by 12 to determine how much money must be set aside each month to cover these necessary occasional costs (use the form on page 17).
5. Total the dollar amounts determined in steps 2–4. Subtract them from your income to determine your monthly differences. If this is not a positive number, try again! Trim your expenses, or increase your income!

### Income

Earned income . . . . . \$ \_\_\_\_\_

Child support/alimony . . . . . \$ \_\_\_\_\_

Social Security . . . . . \$ \_\_\_\_\_

Unemployment . . . . . \$ \_\_\_\_\_

Public assistance . . . . . \$ \_\_\_\_\_

Food stamps (SNAP) . . . . . \$ \_\_\_\_\_

Cash gifts . . . . . \$ \_\_\_\_\_

Other . . . . . \$ \_\_\_\_\_

Other . . . . . \$ \_\_\_\_\_

**(A) Total income** . . . . . \$ \_\_\_\_\_

and enjoyable. To make this budget work, it must be developed by the entire family and it requires tough choices. It won't be easy, but it will help you get out of debt and move forward and *that* will be more comfortable and enjoyable than being in debt.

### Expenses

Housing . . . . . \$ \_\_\_\_\_

Utilities:

    Electric/gas/heating oil . . . . . \$ \_\_\_\_\_

    Phone . . . . . \$ \_\_\_\_\_

    Water/sewer . . . . . \$ \_\_\_\_\_

    Trash . . . . . \$ \_\_\_\_\_

Food (at home and away) . . . . . \$ \_\_\_\_\_

Transportation . . . . . \$ \_\_\_\_\_  
(car payment, insurance, gas, bus fare, parking, etc.)

Child support/alimony payment . . . \$ \_\_\_\_\_

Essential personal needs such as prescriptions . . . . . \$ \_\_\_\_\_

Debt repayment . . . . . \$ \_\_\_\_\_

Household operations . . . . . \$ \_\_\_\_\_

Occasional expenses . . . . . \$ \_\_\_\_\_  
(from completed occasional spending form, page 17)

Other . . . . . \$ \_\_\_\_\_

Other . . . . . \$ \_\_\_\_\_

**(B) Total expenses** . . . . . \$ \_\_\_\_\_

Income (Line A): . . . . . \$ \_\_\_\_\_

Minus expenses (Line B): . . . . . \$ \_\_\_\_\_

Total monthly difference: . . . . . \$ \_\_\_\_\_

1. Enter the amounts you spend on items paid for occasionally under the months that you pay for them.

2. Add across each row to find the total yearly cost of each item.  
 3. Add figures in yearly totals column to determine total amount needed for occasional expenses.

4. Divide by 12 to determine how much to set aside each month for these expenses.

Amount to set aside each month: \$ \_\_\_\_\_ to meet average monthly occasional expenses

Occasional spending for the down-sized budget														
Item	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Column A Yearly totals	Monthly budgeted amount (Column A ÷ 12)
Automobile License/plates Oil change/ maintenance Insurance														
Medical Doctor visits Dental Non-monthly prescriptions Glasses														
School Fees/tuition Supplies														
Other														
<b>Total: \$</b>														

Step 6. Develop a repayment plan using the concept of power payments: The total amount of money spent on debt repayment each month will remain the same until all debts are repaid.

Make the monthly payment on secured loans and the minimum payment on other debts each month.

When the first debt is paid in full, add the amount you have been paying on that debt to the minimum payment on the second debt. Pay that total each month on the second debt until it is paid in full. Continue to make the minimum payments on the rest of the debts.

When the second debt is paid in full, add the amount to the payment on the third debt. Make minimum payments on the rest of the debts. Continue in this manner until all debt is eliminated. This strategy is called a power payment plan. Powerpay<sup>®</sup> software was developed by Utah State University Cooperative Extension Service and will calculate a personal power payment plan for you (<https://powerpay.org>). It allows you to compare repayment plans that begin by first

paying off the highest interest, the smallest balance, or the shortest term debt. It shows the total interest costs and length of repayment time with and without the use of power payments. It can also incorporate a lump sum payment and show how this will affect the repayment time and total interest paid. Remember, this repayment method assumes that you have stopped making purchases on credit.

Step 7. Identify an amount of money, above the minimum payments due, that can be applied each month to debt repayment. This money might come from cutting back spending or taking an extra job. See section 5. Your repayment plan will be more effective because the time to repay all your debts will be decreased and you will save considerable money in interest.

Step 8. Use lump sum payments from overtime pay, bonuses, income tax returns, or gifts to decrease debts or pay a debt fully. They will further decrease repayment time and the total interest charges paid.

Sample list of creditors for repayment plan using power payments:

Creditor	Balance Owed	Monthly Payment	Annual Interest Rate (APR)
Department Store	\$1,200.00	\$50.00	20.4%
Primary Credit Card	\$3,000.00	\$65.00	18.0%
School Loan	\$3,000.00	\$100.00	9.0%
Car Loan	\$5,000.00	\$150.00	10.0%
Maxed Credit Card	\$9,000.00	\$200.00	12.9%
<b>Total:</b>	<b>\$21,200.00</b>	<b>\$565.00</b>	

The time required to pay off these debts without using power payments is six years, eight months. Total interest costs will be \$7,161.08 and the total paid will be \$28,361.08.

Example of debt repayment plan using power payments:

	Department Store	School Loan	Car Loan	Primary Credit Card	Maxed Credit Card
<b>Month</b>					
<b>1-31</b>	\$50.00 (times 31 months)	\$100.00 (times 31 months)	\$150.00 (times 31 months)	\$65.00 (times 31 months)	\$200.00 (times 31 months)
<b>32</b>	\$5.05	\$100.00	\$150.00	\$109.95	\$200.00
<b>33-34</b>		\$100.00 (times 2 months)	\$150.00 (times 2 months)	\$115.00 (times 2 months)	\$200.00 (times 2 months)
<b>35</b>		\$11.33	\$150.00	\$203.67	\$200.00
<b>36-39</b>			\$150.00 (times 4 months)	\$215.00 (times 4 months)	\$200.00 (times 4 months)
<b>40</b>			\$32.09	\$332.91	\$200.00
<b>41</b>				\$365.00	\$200.00
<b>42</b>				\$364.80	\$200.20
<b>43-48</b>					\$565.00 (times 6 months)
<b>49</b>					\$311.48
<b>Totals:</b>	<b>\$1,555.05</b>	<b>\$3,411.33</b>	<b>\$5,882.09</b>	<b>\$4,481.33</b>	<b>\$12,101.68</b>

Notes:

Payments remain constant each month (\$565).

Assumes no new credit purchases.

Calculated paying off highest interest first.

The time required to pay off these debts using power payments has reduced to four years, one month. Total interest cost will be \$6,231.48 and the total paid will be \$27,431.48.

In this example, using power payments would reduce the debt repayment time by two years, seven months and save you \$929.60 in interest.

## Advantages of a self-directed repayment plan:

- You can make a plan and pay your debts completely without involving a third party, so it is confidential.
- Payments made on time for an extended period will actually begin rebuilding your credit record.
- It results in a feeling of success as each debt is paid in full.
- Total interest paid is reduced.
- Time to eliminate debt is reduced.

## Challenges:

- Self-discipline is necessary to stick to the plan.
- No additional credit purchases can be made.
- Current lifestyle may have to be curtailed in order to meet debt obligations.
- It is more challenging if your basic needs plus debt payments exceed your income.
- Extra money such as tax returns, overtime, and bonuses during the repayment period should be used for debt repayment.
- If at all possible, continue to add to savings each month to meet emergencies and unexpected expenses that arise during the repayment period.

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*Powerpay*®, *Version 5.0 for Windows*®. Utah State University Cooperative Extension Service. Logan, Utah 84322-3050: <https://powerpay.org>

# Credit Counseling Services

When you are desperate because of your financial situation and feel you have no place to turn, one possibility is to seek financial counseling. There are several factors to consider when deciding whether financial counseling is an appropriate course of action for you. This information may also be useful when choosing a counseling agency.

You might consider counseling when you:

- are being harassed by bill collectors;
- have mostly credit card debt;
- have tried to work out a plan with creditors and failed;
- have not been able to follow a workable budget; or
- can't keep track of mounting bills.

## Finding a nonprofit debt management agency

There are a number of ways to find certified credit counselors. Look for a nonprofit credit counseling agency that is a member of the National Foundation for Consumer Credit and its affiliated agencies: Consumer Credit Counseling Services, 8611 2nd Avenue, Suite 100, Silver Springs, MD 20910. Call (800) 388-2227 or (301) 589-5600 to locate members in your community. Online, look for: [www.nfcc.org](http://www.nfcc.org).

- Check with your local information and referral service.
- Contact one of the more than 3,000 offices of the Extension service across the country by visiting <http://www.extension.org>. In some communities, Extension provides education and information on debt management. In most cases, Extension does not act as a third party distributing payment; however, they can direct you to a reputable agency.
- Contact the United Way or Chamber of Commerce for information about local services.
- Check under "Credit and debt services" in the yellow pages of your phone directory.

## Repairing your credit

Before contacting a credit agency, understand that your credit history is already likely very poor and only you can "repair" your credit file. Obtain your free credit report at [www.annualcreditreport.com](http://www.annualcreditreport.com), check it for accuracy, and correct any incorrect information. You may add a 100-word statement to your credit file explaining the circumstances regarding negative information. Improving your credit history will require paying bills on time and may require using a secured credit card (where you deposit money into a savings account to establish a line of credit). A secured credit card, if used, should be paid off each month. In approximately two years, after demonstrating that you are a responsible consumer, you might be able to obtain an unsecured credit card at a competitive rate of interest with a reasonable credit limit and terms.

No one can remove accurate information from your credit file. Negative information will remain on your report for seven years. Bankruptcies will likely be reported for ten years. Beware of organizations who offer "credit repair" or schemes to get rid of a bad credit history quickly.

## Selecting a credit counseling agency

Here are some things to consider when selecting a credit counselor:

- Contact your state attorney general's consumer information office to be certain the agency you are planning to call has a good reputation.
- Contact the Better Business Bureau to assure the agency is in good standing and be certain there are no complaints about the agency.
- Find out if the agency specializes in debt management, also known as credit counseling.
- Talk with someone who has used the service.

When contacting the credit counseling agency ask the following questions:

- Is this a nonprofit or for-profit organization? Nonprofits are usually more consumer friendly.

- How is the organization financed? Some nonprofits charge a small fee to the consumer and also receive funds from creditors. The agency may receive up to 15 percent of each payment they collect for the creditors. However, your account should always be credited with 100 percent of the amount you pay through the agency, whether or not a portion of your debt stays with the agency.
- Who pays for the services? This tells you whether they are serving your interests or the creditors' interests.
- How much will I be charged? Some credible agencies may charge nothing or a small fee (approximately \$20 to \$50) for their service, but this is usually voluntary. Most reputable agencies will not turn people away when they can't afford the fee. Don't use an agency that charges several hundred dollars.
- Does the agency pay your creditors directly or do you? How will you know that your payments are made promptly to your creditors? Look for an agency that provides monthly reports. These reports allow you to track the payments to your creditors and let you see your progress.
- How will the organization work with you? Whether they provide classes, one-to-one assistance, counseling by phone, by fax, or e-mail, choose an agency that operates in a way that is comfortable for you.
- How does this organization discuss bankruptcy? If bankruptcy is not mentioned as a possible solution along with other options, ask questions about it. Sometimes bankruptcy is the best solution. A credit counseling agency that won't recommend bankruptcy when it is the best alternative is the same as an attorney who only suggests bankruptcy when there may be a better solution to your financial problem.
- What qualifications do the counselors have? Both the National Foundation for Consumer Credit and the Institute for Personal Finance offer certification programs. Counselors trained by these organizations must pass examinations and subscribe to a code of ethics. Ask about the training the agency requires of its counselors.
- If the agency handles your money, are employees insured against theft or mismanagement?

- What measures are taken to assure that your financial information is kept confidential?

Beware ...

- If the agency tries to loan you money to pay off your bills, it is not a legitimate credit counseling agency. It is a loan company.
- If the agency guarantees to "fix" or repair your bad credit, don't use their services. No one can remove negative information from your credit report if it is accurate information. Other than paying bills and waiting seven years for the negative information to be removed, there is no way to change the information on your credit report.
- Ask for the agency's IRS approved 501(c)3 Federal ID number. The agency should also disclose all of its funding sources.

## What to expect

After your first call to the agency, you will probably receive a worksheet to list all monthly income and expenses. The Know What You Owe form in this booklet (pages 7–9) can help with gathering this information.

Read carefully any contract you are required to sign. If you withdraw from the debt management program before the agency has recovered its costs, you could find that you owe the agency for funds they lose when you leave the program before the specified time.

- When you meet with the credit counselor, you will develop a budget plan that meets your minimum living expenses and debt repayment requirements. At this point, you will decide whether you want to participate in a debt management plan or whether you will use the counselor's suggestions and educational resources to manage your debt on your own. (See section 3, Self-directed repayment plans.)
- If you decide to work with a credit counselor, you must agree to their terms. This may include cutting up credit cards and not using or applying for additional credit. You may also be directed to contact creditors to have your accounts closed. Your counselor may have your best interests in mind but destroying all cards and closing accounts will limit your options during an emergency and will negatively impact your credit score.

- Based on the budget you and the counselor work out, each month you will provide money (by money order, payroll deduction, or automatic check withdrawal rather than a personal check) to the counseling agency. The agency will distribute payments to your creditors according to the schedule developed by you and the counselor. To be successful, your repayment plan must be paid regularly and in a timely way. This plan may be extended for several years or until the debt is retired. While you are participating in a debt management program, your credit counselor may negotiate with your creditor to reduce or suspend interest charges.

### Differences between debt management, trusteeship, and Chapter 13 bankruptcy

- The three are similar in that you develop a budget and plan to repay your debts by making one monthly payment to a third party who then pays your creditors. Trusteeship is obtained when a demand has been made following a garnishment, attachment, or aid of execution (which are legal proceedings), and you contact the county court or municipal court where you live or work. You may then choose trusteeship or a credit counseling service as a method of paying creditors.
- There is a fee for both credit counseling and bankruptcy services. The credit counseling fee may be waived if you can't afford it. If you file for bankruptcy, you will have to pay the filing fee plus attorney fees. If the clerk of court acts as trustee, the court is not compensated.
- If you miss a payment to a credit counseling service or the trustee, creditors can start collection actions against you. If you miss a payment during your bankruptcy plan, you are protected from creditors.
- Most credit counseling programs require payment of the debts in full and many of the creditors continue to charge interest. In Chapter 13 bankruptcy, you will pay a percentage of the full amount you owe.
- If you have entered into an agreement with a credit counseling agency or if you apply to your local municipal or county court for the appointment of a trustee to receive the part of your earnings that is not exempt from garnishment, you may protect yourself from future garnishments. However, a

creditor can state an objection (in writing) to your participation in this debt management plan and can be excluded from the agreement. Filing a Chapter 13 or Chapter 7 bankruptcy provides an “automatic stay” that prevents creditors from seizing your assets or taking other actions to obtain payment. (See **section 6.**)

### Debts not covered in the plan

Debt repayment plans usually cover unsecured debt such as credit cards. Your auto and home loans are considered secured debt and are usually not included in the repayment plan. You will have to continue payments to these creditors yourself.

### Credit counseling and your credit report

If you have been late in making payments on credit accounts, this information has probably been reported by your creditors. Under the Fair Credit Reporting Act, accurate information will remain on your credit record for up to seven years. When you are enrolled in a debt management program, your creditors will probably report information about the accounts in your repayment plan. They may report that the account is in a debt management plan with a financial counseling agency, that your debt has been restructured, or that the debt has been written off. In the future, potential creditors, employers, or insurance companies may or may not consider debt management or bankruptcy to be negative information.

When under financial stress, your decision-making skills will be pressed to the limit. Make sure you think through all your financial choices. You do have options. Consider all the consequences carefully when choosing between a debt management plan offered by a credit counselor or court trustee, other self-help solutions, or bankruptcy. Decide what course of action will be best for you in the long run.

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# Consolidation and Other Repayment Strategies

A consolidation loan may be a reasonable and affordable alternative repayment plan. In this strategy, a loan is taken out to pay all other debts. It may reduce your total monthly payment and simplify payment to one instead of many but will extend the repayment time. Increasing the repayment time also increases the amount paid in interest or finance charges. However, you can sometimes refinance these loans at a lower interest rate and monthly payments are usually smaller.

Two points of caution: (1) if you consolidate your debts, be careful not to use the “freed up” money to buy something else on credit; (2) it is not usually a good idea to use a home equity loan for debt consolidation. That debt is now “secured” by your home. If you get behind on repayments, you could lose your home.

Before considering a consolidation loan, see if you can work out a self-administered repayment plan. Investigate other alternatives for paying off your debts. Those alternatives have been discussed in **sections 2 and 3**.

The completed Know What You Owe chart on pages 7–9 will be necessary to obtain a debt consolidation loan. A well-chosen consolidation plan can reduce your monthly payments while still allowing you to meet your obligations. However, a poorly chosen one can put you deeper in debt. There are many ways to get money for debt consolidation, including borrowing from yourself, friends and family, life insurance, retirement accounts, pawn shops, and finance companies. Each has advantages and disadvantages, so choose wisely.

The ability to get a consolidation loan depends on:

- your credit history;
- the amount of equity in your home;
- the source(s) and amount of your income; and
- the size of your debt and the amount of money required to pay that debt.

## Borrow from yourself

Money in savings accounts, Certificates of Deposit (CD), stocks, bonds, or retirement accounts can be used to consolidate debts. A banker or investment advisor can provide information about your options. Withdrawing money from your account or cashing in your investments is a major decision. Determine the cost by adding the interest the money is earning and any fees, taxes, or penalties that would have to be paid.

Is the money in your savings account earning a small amount of interest? Would it be better to eliminate debts involving high interest rates? If earnings (interest) from the investments are low and you know you can repay yourself quickly, this may be an acceptable option. However, if earnings are reasonable and you do not believe you will be able to repay yourself in a short amount of time, it may be best to leave these funds alone.

Borrowing from your “rainy day” fund is a risk. It is important to have some money available for an emergency fund.

## Borrow from family or friends

Loans from family and friends should be handled as if they are bank loans. Develop a written contract listing the terms. Include the loan due date, interest rate, late charges and when they would take effect, collateral or security to guarantee the loan (if any), and payment plan. All parties should sign, date, and keep a copy of the document.

Can your family member or friend afford to make this loan to you? If so, he or she may be able to set the interest rate lower than one available from another source. You also need to decide if you really want to owe this person money. If you are unable to repay the loan, you could destroy the relationship.

## Life insurance

A cash-value life insurance policy could be used for a loan to yourself. You can often borrow most of the policy's cash value at a reasonable interest rate with the ability to repay as slowly or as quickly as you choose. While it may be tempting not to repay at all, keep in mind that the loan would reduce your death benefit.

It is important to find out how the loan affects the death benefits, cash value, interest rate you are paying (often higher than stated since the policy will earn less interest while the loan is being repaid), and whether you will have insurance in place while repaying the loan.

## Retirement account

You may be able to borrow against your 401(k), 403(b), or profit-sharing retirement account. The interest is usually low and repayments go directly back into the account. However, if you withdraw the money without repaying, the IRS will require payment of penalties and taxes. If you leave your job before repaying, you may be required to repay the balance in full. Your investment may earn less while you are using the money for your debts, leaving less money for retirement.

## Pawn shops

Some people raise money for their debts by taking items to a pawn shop. Pawnbrokers will give cash for secondhand items including musical instruments, electronics, baseball cards, and jewelry, often 25 to 50 percent of the value of the item. Old diamonds and watches can easily be pawned.

Pawnbrokers also give loans on selected items with rates as high as 25 percent per month or 300 percent per year. If you fail to pay the interest and redeem the item, it will be sold and the pawn shop will keep the money. Call or visit several shops to see if you get a different valuation each time. This will ensure you come away making the most money.

## Home equity loans

Home equity loans are often used for debt consolidation. With a home equity loan, the lender offers a line of credit, sometimes for amounts more than the home's appraised value minus the amount

of the mortgage. Home equity loans are available as a second mortgage (allowing you to borrow a predetermined amount of money for a specific amount of time) or as a home equity line of credit (allowing you borrow up to a pre-approved credit limit).

Interest paid is tax deductible if you itemize deductions and the amount borrowed does not exceed the value of your home. If you have a good credit history and a steady employment record, interest rates may be lower than from other loan sources. Without a good credit history, expect higher interest rates, closing costs, and other fees. Watch out for low introductory rates that jump after several months. Also use caution if you accept a credit card tied to the home equity line of credit. It can be very tempting to use that card to accumulate even more debt.

Beware of putting your home on the line with a home equity loan. Will you be able to make payments? If you have to move, could you sell your home at its current or a higher value? In general, it's not a good idea to exchange unsecured debt for secured debt.

## Consumer finance companies

Debt consolidation is often managed through a consumer finance company. Most companies will combine your bills into one loan with a fixed monthly payment and a fixed repayment period. In most cases, the repayment time is extended. This longer repayment time combined with higher interest rates can greatly multiply the total amount of money paid.

Finance companies make secured and unsecured loans for debt consolidation. A secured consolidation loan requires you to pledge your house or car as collateral. Interest rates may be 10 to 15 percent but could be higher. If you default on the loan, the finance company can foreclose on your home or take your car.

An unsecured consolidation loan would provide money without requiring you to pledge your home or car as a guarantee to repay. Interest rates are often as high as 25 percent. Additional fees (some hidden) can send the interest rate closer to 50 percent.

A potential future creditor will look at a loan from a finance company negatively since it shows you have had debt problems. Finance company consolidation loans are often used by people with high debt as a last attempt to handle the debt themselves.

Shop around before choosing a consumer finance company. You want to know the annual percentage rate (APR), fees charged, monthly payments, length of the loan, total amount you will pay, what happens if you are late or miss a payment, and if there is a prepayment penalty. Watch out for bill paying services claiming to consolidate your debt. You will pay for their service and could get stuck with a dishonest company.

If a debt consolidation loan is being considered, investigate banks, savings and loans, and credit unions. These may be better options than a consumer finance company since others are often more willing to work with you if you have trouble repaying. If you are a customer and can have payments automatically deducted from your account, you may qualify for a lower interest rate.

### Advantages of debt consolidation

- Consolidation requires only one monthly payment rather than many. Since this may simplify bill paying, it may help assure that the bill is paid on time and in the amount promised.
- The interest rate may be lower than with other debts.
- The monthly payments are usually lower than the combined total of all former debts.

### Disadvantages of debt consolidation

- Reducing the monthly payment may tempt you to take on more debt.
- If there is any possibility that you may eventually file bankruptcy, be cautious about changing unsecured debt (credit card debt, medical bills, etc.) to secured debt through debt consolidation.
- You could lose your home if you take out a mortgage to pay off the unsecured debt (even if it would allow you to lower the interest rate you are paying) and you continue to have financial problems. Unsecured creditors will have to take you to court to collect money but a secured creditor can take your home.

### Consider this

Stretching out repayment terms is almost always a bad idea. A consolidation loan may be smart if you:

- have a high amount of debt;
- have a very high interest rate on that debt; or
- are considering borrowing more money at a high interest rate.

A consolidation loan is a bad idea if you:

- are not committed to repaying that debt;
- will be tempted to use the “freed up” money to accumulate more debt; or
- will be trading unsecured debt for secured debt and thereby risk losing your home or car.

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# Bankruptcy

When you have done everything you can to pay your debts and you are still totally overwhelmed by the amount you owe, your final resort may be personal bankruptcy. If you are looking for more information about bankruptcy and how to file, you are not alone. In 1970 there were less than 100,000 personal bankruptcies in the United States, but by 2005 a record 2,078,415 were filed! In the same year, revisions to the bankruptcy law were enacted that made filing for bankruptcy more difficult. This resulted in a dramatic decrease in filings: down to 617,660 nationwide in 2006. Bankruptcy was on the rise again in 2007: up to 850,912 for the year and the trend continues upward. Clearly, many people choose bankruptcy as a solution to their personal debt. But is bankruptcy the right decision for you?

Filing personal bankruptcy involves a U.S. District Court proceeding in which the obligations of the debtor (the person who owes the debt) are balanced against the claims of the creditors (the individuals or companies to whom the debt is owed). The objective of the debtor is to reduce debt or eliminate it completely. The objective of the creditor is to collect as much of the debt as possible. The bankruptcy proceeding is the legal process to help the debtor and creditors resolve their differences.

## Bankruptcy—is it right for you?

You should thoroughly explore other debt payment options prior to considering bankruptcy. You may be able to settle your debts through debt consolidation, with the help of a financial counselor, generating more income, or spending less. The previous sections of this booklet will help you explore these options.

Your debts will either be secured or unsecured. A secured loan has an established installment payment required on a regular schedule. When you agree to a secured loan, you pledge to give up something of greater value, such as your house or car, if you can't repay. The property that the creditor may seize according to the loan agreement is called collateral. Secured loans also allow the seller to repossess the

merchandise purchased when payments aren't made on time.

Unsecured debt is not tied directly to a written repayment plan and the creditors have no collateral against the debtor. Common unsecured debt includes medical bills and most credit cards. Interest for an unsecured debt is often much higher than secured debt because the creditor may not be able to collect without taking the debtor to court.

If your primary debts are loans for secured items such as a house or a car, you may lose them even if you file for bankruptcy.

Weigh carefully the consequences of filing bankruptcy. If creditors are not beating on your door for payments and your property and wages are not being affected, don't be too quick to file bankruptcy. You may also want to rethink filing if doing so means you will lose assets that have family or sentimental value.

For most people, there are two personal bankruptcy options: **Chapter 7—Liquidation of Debts** (sometimes referred to as “straight bankruptcy”) or **Chapter 13—Adjustment of Debts of an Individual with Regular Income** (sometimes known as “reorganization,” “individual debt-adjustment,” or the “wage-earner plan”).

There are rules for determining which type of bankruptcy the consumer can file by implementation of a “means” income test and other requirements. Restrictions are designed to prevent high-income individuals from liquidating most of their debt without fully exploring options to pay off their creditors.

## When bankruptcy is the best choice

Bankruptcy is governed by federal law and will be handled through the federal judicial district in your geographic area. You will find bankruptcy courts listed in the phone book in the U.S. Government Offices section under Bankruptcy Court. Calling the district bankruptcy court may help you gather some

helpful information, but their office staff normally deals directly with attorneys who are familiar with the process and have questions regarding cases. Court clerks cannot give legal advice and therefore don't want to be asked. General information is best obtained through an attorney who is experienced with the federal Bankruptcy Code.

The bankruptcy process normally includes consulting an attorney, taking part in credit counseling from a government-approved organization, filing a petition, filing "schedules" that describe your financial situation, meeting with your creditors, establishing a liquidation or repayment plan, and completing a pre-discharge financial education program to help avoid financial crisis or filing bankruptcy again in the future.

A trustee will be assigned to oversee your case. The trustee works for the U.S. Department of Justice and is responsible for checking the required paperwork, reviewing the listing of assets and liabilities, and reviewing claimed exemptions. The trustee may meet with you and your creditors to discuss your debts. This is known as the "341 meeting" and provides creditors an opportunity to gather information about who you owe and how much you owe. The trustee assures that the proceeds from the sale of non-exempt property is distributed to creditors as determined by court order. In Chapter 13, the trustee will attend a hearing to approve a repayment plan, accept your monthly payments, and distribute repayment to your creditors.

Filing for bankruptcy is a matter of public record and names of individuals filing are sometimes published in the newspaper. There are unscrupulous "counselors" who may see your name and contact you to offer assistance at a price. They will charge fees for their services to help you reestablish good credit and offer high interest, high-risk loans. "Rip-off" lenders know the bankruptcy laws well and use them to their advantage. They prey on people who have filed bankruptcy because they know that the bankruptcy filer can't file again for six years. They will get their money from you through harassment if need be. Remember, no one but you can reestablish good credit, so make good use of the list of approved credit counselors and education providers available through your attorney and at the U.S. Department of Justice web site at [www.usdoj.gov/ust/eo/bapcpa/ccde/cc\\_approved.htm](http://www.usdoj.gov/ust/eo/bapcpa/ccde/cc_approved.htm).

### Advantages of filing bankruptcy

- Provides a manageable, court-ordered process to settle with creditors.
- Provides an "automatic stay" that freezes actions by creditors trying to seize your assets. In Chapter 13, the automatic stay protects your home from foreclosure and prevents repossession of your car. It prevents wage garnishment, harassment by creditors, and termination of utilities. Utility services are restored in both Chapters 7 and 13.
- Prohibits the IRS from seizing your property for back taxes, although you still have to pay those taxes.
- Suspends additional interest or finance charges on debts.
- Provides an opportunity to start fresh and usually provides relief from stress.
- Although bankruptcy will require patience and a lot of paperwork, it may be faster and easier than other options for getting out of debt.
- Government programs can't discriminate against you for filing bankruptcy.

### Disadvantages of filing bankruptcy

- The "automatic stay" is only temporary. It cannot provide long-term relief from foreclosure or repossession. The law allows landlords to bypass the automatic stay provisions and proceed with residential evictions.
- Filing bankruptcy involves a lot of paperwork, is time consuming, and can be very confusing.
- Any property you transferred to someone else within the past year is subject to ownership review. If you sold something, you must have received something equal to its value in return. People faced with bankruptcy are often tempted to hide assets because they fear losing them to creditors. Don't try to hide assets; a judge may see such an attempt as fraud.
- Bankruptcies are a matter of public record. Your personal financial history will be open to the scrutiny of others including potential employers, landlords, and insurance companies. Emotional stress and embarrassment may result.

- Private businesses can discriminate against you by denying you credit.
- Although it is illegal for a potential employer to discriminate against individuals who have filed for bankruptcy, it happens. Potential employers may have job applicants sign a release to gain access to credit reports and may choose another candidate if they discover a bankruptcy in your report.
- Secured creditors are entitled to the belongings for which you are unable to pay and/or the money you owe. They may have to accept lower payments over more time than was originally agreed upon (Chapter 13), but you will either pay them or return their property.
- There are filing fees and other costs. The fees are several hundred dollars to file any type of bankruptcy. For current fees, call the bankruptcy court in your area (normally listed under U.S. Government in the phone book). Fees can be paid in installments, but if fee payments aren't made, the case will be dismissed. Attorneys will also charge for their services. Attorney fees vary, but Chapter 7 requires less time and legal advice so it normally costs less than Chapter 13. Joint filing fees are higher. Attorneys often expect one-fourth of their fee to be paid up front.
- Although the debt forgiven is not considered personal income after bankruptcy, the amount of the discharged debt may appear on your 1099 income form. This, and the fact your finances are now more involved, will make filing personal income tax forms more difficult.
- Renting a home or obtaining a home loan may be difficult because of your damaged credit.
- Legally, both Chapter 7 and Chapter 13 can be on your credit report for ten years from the day you filed for bankruptcy. Three major credit bureaus usually remove successfully discharged Chapter 13 bankruptcies after seven years.
- Because bankruptcy negatively impacts a person's credit score, you may be denied credit or be charged higher interest rates in the future. Without a credit card, it is difficult to rent a car, cash a check, or make reservations for a flight or a hotel room.
- Utilities cannot deny you service because you have filed bankruptcy in the past; however, they may require a deposit prior to reestablishing service.
- Bankruptcy requires you to place your affairs under court scrutiny. A creditor or the trustee can therefore intrude into your life to be certain you are legally entitled to the relief you are seeking.

## **Mandatory credit counseling and debtor education requirements**

Regardless of the type of bankruptcy, filers are required to go through both a pre-filing credit counseling session and a post-filing debtor education course before the bankruptcy is finalized and debts discharged. These are offered by government approved organizations. The required pre-filing credit counseling can take place in person, online, or over the phone and normally takes about 1½ to 2 hours.

The credit counselor will help you determine whether bankruptcy is necessary or whether you can recover financially using an informal repayment plan. They will advise you on managing your money and help you develop a budget. Sometimes the credit counselor may recommend and negotiate a debt management plan (DMP). A DMP allows you to deposit money each month with the counseling agency, which then uses the money to pay your creditors according to an agreed upon plan and schedule they have worked out with you and your creditors. A DMP is not required for filing bankruptcy, but if you do use one, a copy must be provided to the bankruptcy court when you file.

You are only required to participate in the counseling but not a repayment program. If a debt management program is recommended, you will need to submit it to the court, along with a certificate showing that you completed the counseling.

Once the bankruptcy has been filed, a two-hour class provided by an authorized education provider is required before the bankruptcy can be officially discharged. These classes may be offered in person or online. As with pre-filing credit counseling, the fee for this post-filing course may be waived if you are unable to pay. You will be issued a second certificate once you have completed the debtor education requirements.

Make certain that you choose a credit counseling organization and an education provider that is approved for your judicial district. For a list of approved counselors and education providers in your area, go to the United States Department of Justice Trustee office web site at [www.usdoj.gov/ust/eo/bapcpa/ccde/cc\\_approved.htm](http://www.usdoj.gov/ust/eo/bapcpa/ccde/cc_approved.htm). When you click on your state, a list of approved organizations will be displayed but they will not all be in your state. Many provide online-only services rather than services in person. You should carefully consider the method of information delivery that best suits your learning style when choosing a credit counseling or teaching organization. You can also get a list of approved providers by contacting the bankruptcy clerk office in your federal court jurisdiction. Your attorney may direct you to a specific credit counselor or education provider. You should, however, contact several before settling on which one to employ.

## Chapter 7

Chapter 7 allows you to discharge nearly all personal debt. You will no longer be legally required to pay debts that are discharged. In simple terms, you list your assets and liabilities and give control of your property to the court. Much of it is sold to repay your debt.

### Eligibility for filing Chapter 7

Any person who lives in and has property or a business in the United States may be able to file Chapter 7 bankruptcy if they meet the strict eligibility requirements.

There is no maximum debt restriction; however, there is a time restriction. You cannot file for Chapter 7 if either your debts were discharged in a previous Chapter 7 or if you filed a Chapter 13 within the past six years and paid less than 70 percent of your debt.

In addition, there are income restrictions designed to prohibit filers with higher than median incomes from abusing Chapter 7. If your average income (based on the six months prior to filing bankruptcy) is equal to or less than the median in your area, you can file a Chapter 7. If it is more, you must pass a second “means test” designed to determine whether you have enough disposable income to make consistent payments on a Chapter 13 plan. This is determined

after subtracting specific allowed expenses for basic living costs, as well as secured or high priority debt payments from your average six-month income prior to filing. Determining your eligibility for Chapter 7 will likely require the help of an attorney familiar with the means test restrictions.

### Exemptions and property values

Chapter 7 filers must value property at the replacement rate—what it would cost to replace it from a retail vendor, although the age and condition can be considered. Individuals must be residents of their state for at least two years in order to use the state’s exemption laws. Exempt property is property that cannot be taken by creditors or the trustee to repay debt. Valuable heirlooms and other property that you might want to keep may not fall within the “exempt property” categories offered in most states. But state exemption laws are normally less rigorous than the federal provisions. To use a state’s homestead exemption, you must live there for at least 40 months prior to filing bankruptcy.

### Advantages of Chapter 7

- It can permanently wipe out your obligation to pay back many unsecured debts. These generally include credit card debt, medical bills, and past-due utility payments.
- It is possible to get credit approval because some lenders see bankrupts as good risks. A bankruptcy filer cannot file another bankruptcy for at least six years and has no outstanding debt. However, credit terms for previous bankrupts are strict and very costly.
- It takes a few weeks to complete the paperwork and about 40 months to close the case after one or two trips to the courthouse. Chapter 7 is quicker and less complex than Chapter 13.
- You will likely be allowed to keep a limited dollar value in the following assets: your home, a car, standard household goods, tools required for work, insurance policies, and prescription health-related equipment. The amount of equity you retain in your house or other property varies widely from state to state. All other assets are sold. Money generated after paying court costs will be distributed to your creditor(s).

## Disadvantages of Chapter 7

- You may lose some personal assets.
- Some debts (taxes, student loans, alimony, child support, divorce/dissolution debts, property settlements, criminal fines, and claims for punitive damages or court restitution orders) may remain.
- You cannot file Chapter 7 if you were discharged from your debts under Chapter 7 within the past eight years or if you filed Chapter 13 within the past six years (filing date).
- Debts incurred within 40 days of filing and additional debt you take on after your filing date are NOT discharged—you must pay them.
- Although co-signers are protected when you first file bankruptcy, creditors will likely contact them to pay your debt. The co-signer may have to pay all or part of your loan, even if you are discharged from paying because of filing bankruptcy. This may cause friction in your relationship, if you still have one.
- You will have failed to meet an obligation to pay for goods and services someone provided to you because they trusted you to pay for them later. You have betrayed that trust. This may be seen by some creditors as an unwillingness to take responsibility for your debts.

### Chapter 7 is a better choice than Chapter 13 if:

- Most of your property is exempt from being seized and sold.
- Nonexempt property can be exchanged for exempt property.
- Debts causing the difficulties can be discharged under Chapter 7.

## Chapter 13

Chapter 13 is also known as the wage earner plan because it is for people who have a regular source of income. In Chapter 13, you keep your property as long as you make regular payments to the trustee as outlined in the court-ordered repayment plan. The repayment of your debt will likely take three to five years. Past-due mortgage payments are expected to be paid off in three years, but this can be extended to five years if there is a good reason. You may be

expected to pay interest on the debt, as well as the debt itself. The repayment plan is court-approved and the court-appointed trustee oversees payment to your creditors. Chapter 13 does not eliminate your debt, but it can keep creditors from harassing you until a repayment schedule is worked out in the courts.

### Eligibility for filing Chapter 13

To file Chapter 13, you or your spouse must have a stable source of regular income. The income must be high enough to meet the obligations of the repayment plan with enough left to meet basic living expenses. To determine if you can meet these requirements, you will be required to develop a workable budget. You cannot file Chapter 13 if your debts are higher than federal limits. At the time of this printing, your debts are too high to file Chapter 13 if your secured debt exceeds \$1,010,650 and your unsecured debt exceeds \$336,900.

### Advantages of Chapter 13

- Foreclosure proceedings stop when Chapter 13 is filed.
- Unlike Chapter 7, you keep your property, including your house, as long as you make the monthly payments the court arranges for you.
- Although your creditors will get paid, you will not need to have direct contact with them; the trustee will pay them for you.
- You will meet an obligation to pay for goods and services someone provided to you, trusting you to pay later.
- A co-signer may be protected from being held liable for your debt.
- You have five years to completely pay your debts. Your creditors must accept the terms of the court-approved repayment agreement.
- Regular payments for secured debts are often lower because the interest rates established in the pay-back plans are often less than those of the original loan. If you have a car loan, you may only be required to pay the true value of the car itself.
- You may file Chapter 13 anytime, even if you recently filed for Chapter 7 or Chapter 13 and did not complete the process.

- It may be easier for you to reestablish good credit because you will have paid your debts rather than having them discharged.
- Chapter 13 may legally be kept on your credit report for ten years. (That's not good news.) However, the three major credit bureaus often remove Chapter 13 from their records if the debts have been paid off within seven years from the filing date. (That's not good news either, but seven years is better than ten years.)

### Disadvantages of Chapter 13

- You usually have only three years to pay past due mortgage payments. You may have to pay additional interest on the debt you pay back.
- Chapter 13 filers must pay all of their **disposable** income to their repayment plan.
- Attorney fees may be higher for Chapter 13 because it is more complex and requires more time than Chapter 7.
- Nationwide, about 49 percent of Chapter 13 plans are dismissed, 14 percent of the debtors eventually file for Chapter 7, and 3 percent are discharged by being completed as planned.
- If you want to sell your house after filing Chapter 13, the court may need to approve your choice of realtor. The court will stay involved in the sale process and will demand additional paperwork and procedures.

### Chapter 13 is a better choice than Chapter 7 if:

- the delinquent debt is on secured loans (such as a house and/or car),
- more than one secured creditor exists; or
- you want to protect unsecured assets from being sold to pay your debts.

### Handling bankruptcy yourself

Bankruptcy is complicated and will have a long-term impact on your life. Most people are therefore advised to seek the help of an attorney. But the law does not require that you retain an attorney to file bankruptcy. “Do-it yourself” bankruptcy kits are available to help

you understand the bankruptcy process, the records you must gather, the paper work required, and the consequences of filing for bankruptcy. Kits normally focus on Chapter 7 because other types of bankruptcy are a bit more complex and fewer consumers file Chapter 13. A word of caution—the kits tell you that filing for Chapter 7 is a relatively simple matter. You will need to be very well organized, detail-minded, and patient to successfully file bankruptcy without the assistance of an attorney. An attorney will assure that the bankruptcy paperwork is in order and will help steer you through the entire legal process.

Forms for filing bankruptcy and additional information are available on the U.S. Department of Justice web site: [http://www.usdoj.gov/ust/eo/ust\\_org/bky-info](http://www.usdoj.gov/ust/eo/ust_org/bky-info).

There are a number of books available to help prepare for filing bankruptcy:

*How to File for Chapter 7 Bankruptcy* (15th edition) by Stephen R. Elias, Albin Renauer, and Robin Leonard. Nolo Press, October 2008. ISBN #9781413308976.

*Chapter 13 Bankruptcy—Keep Your Property & Repay Debts Over Time* (9th edition) by Robin Leonard, J.D., and Stephen R. Elias. Nolo Press. May 2008. ISBN #9781413308556.

*The New Bankruptcy—Will It Work for You?* (2nd edition) by Stephen Elias. Nolo Press. May 2007. ISBN #9781413306330.

*The American Bar Association Guide to Credit & Bankruptcy*. January 2006. ISBN #0609809261.

### Finding legal assistance

Hiring an attorney to help you sort through the bankruptcy process will incur more debt but it may be a comfort to know that someone who understands the complexities of the system is in charge of your case. If you are married, an attorney can advise you if a single or a joint petition is best. An attorney will be able to explain the legal issues involved in transferring assets to avoid criminal prosecution for fraud. Many problems can be prevented if you are honest and thorough with your attorney and the court.

## The Legal Aid Society

In some communities, the Legal Aid Society may provide bankruptcy filing assistance to individuals or families that qualify under certain income limits. Qualifications and services vary from county to county. Contact your local office for information. To find a legal aid office in your area, visit: <http://www.lsc.gov/map/index.php>. or search for “Legal Aid Society” on the Internet.

### An attorney:

Finding a competent, dependable attorney who will charge a reasonable fee for services may seem overwhelming. Keep the following in mind:

- Understand that you are in a crisis and under emotional stress. You may not be able to make wise choices at this time. Consider asking a trusted friend to help you select an attorney.
- Visit [www.findlegalhelp.org](http://www.findlegalhelp.org) and review posted options for finding an attorney through the American Bar Association.
- Go through the phone book and examine the ads. Are there ads that list bankruptcy? Does the ad use fear, stress, or revenge gimmicks? Is the office location convenient? Do you want an attorney from your home town? Do the office hours fit your schedule?
- Be leery of television and radio ads that promise a quick fix to your financial problems.

### When you call the attorney’s office the first time, ask the following questions:

- Is there a fee for the first visit? If so, how much is it and when is it paid? If you decide not to use the services, is this fee returned?
- What is an estimated total cost for their services? How much of their fee do they expect before doing any work for you? Do they use an installment plan for payment of the rest of their fee? How much more will it cost if the fee is paid in installments?
- Is the attorney a member of the American Bankruptcy Law Forum, the American Bar Association, or a county or state Bar committee? Membership may indicate a higher level of training and professionalism.

- How many bankruptcy cases have they handled?
- Will you be assigned to one attorney, or will your case be handled by several?
- What paperwork, if any, is required for the first visit? Ask for forms that you complete prior to your first visit.

Contact several attorneys by telephone and record how they responded to your questions. Filing bankruptcy is an emotional experience. You need to be able to trust and feel comfortable with your attorney. Review your findings and set an appointment for a meeting.

### When you meet with the attorney:

- Ask a friend to go with you to the first visit. You are understandably anxious to get the bankruptcy process started. A friend may be more objective and less likely to rush into decisions.
- Complete any paperwork provided prior to the first visit. Take your completed Know What You Owe form with you (see pages 7–9). This will minimize the amount of time spent and should lower attorney fees.

Bankruptcy is intended as a fresh start and may be the best way to handle overwhelming debt.

### Ask yourself:

- Can I relate to this person? Do I feel comfortable asking for more information if I don’t understand something?
- Is it clear how, when, and how much the attorney is to be paid? How are the legal fees determined?
- Do you understand what the attorney will do and what you will have to do?
- Do you fully understand the separate steps in the bankruptcy process?

To get more detailed information regarding bankruptcy requirements, rules, and the process, consult an attorney. For more information about bankruptcy law, search “bankruptcy” at the U.S. Department of Justice web site (<http://www.usdoj.gov>).

## References

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Federal Trade Commission. *Before You File for Personal Bankruptcy: Information About Credit Counseling and Debtor Education*, 2006.

Orman, Suze. *The Road to Wealth: A Comprehensive Guide to Your Money*. New York: Penguin Group, 2008.

Pelc, Matthew J. *When You Have to File for Bankruptcy: Step-by-Step Instructions to Take Control of Your Financial Future*. Ocala, FL: Atlantic Publishing Company, 2008.

## Coming Up for Air

Now that you have worked through the tough decisions about day-to-day money questions, it's time to "come up for air." You caught the life preserver that was thrown to you, or swam to shore on your own. Either way, congratulations for taking the steps needed to get and keep your finances under control.

Now it's time to look ahead. What can you do to keep your head above water?

- Stick to the budget you developed to keep yourself out of deep water. As your debt decreases and savings increase, it's reassuring to know that you are prepared for emergencies, occasional expenses that were overlooked, and saving towards your goals. Unexpected expenses will come up, so having money set aside will help you cope when they do.
- Review your credit reports from each of the three credit reporting agencies each year. These free reports are available at [www.annualcreditreport.com](http://www.annualcreditreport.com).
- Once you have received your credit reports, check them for accuracy. Correct any incorrect information. You may add a 100-word statement to your credit file explaining the circumstances regarding negative information.
- Remember that no one can remove accurate information from your credit report. Negative information that is true will remain on your report for seven years. Bankruptcies will likely be reported for ten years.
- Work on repairing your credit. Before contacting a credit agency, understand that your credit history is already likely very poor and only you can "repair" your credit record. Beware of organizations who offer "credit repair" or schemes to get rid of a bad credit history quickly. (See section 4 for more information.)
- Improving your credit history will require paying bills on time and may require using a secured credit card. This card, opened at a financial institution, requires that you deposit money into a savings account to establish a line of credit. The secured card, backed by your money, can be used to rebuild a credit history. It is important to pay off the balance each month. In approximately two years, after demonstrating that you are a responsible consumer, you may be able to obtain an unsecured credit card at a competitive rate of interest with a reasonable credit limit and terms.
- Once a year, prepare a net worth statement to track your assets (what you own) and your liabilities (what you owe). Consider doing this around your birthday or income tax time so you will remember. This "snap shot" of your financial situation will show your progress toward increasing your net worth.
- Keep the lines of communication open with family members. Everyone in the family has responsibility for keeping the family finances afloat. Work together on goals and reviewing wants and needs daily.

Managing money doesn't come easily to everyone. Yet getting control of finances provides a feeling of freedom and security. No matter how much or how little your income, carefully consider every day spending and saving decisions to promote sound financial management. These decisions will lead you to a positive financial future! You're well on your way to a successful future. Keep swimming!

