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CREDIT CARD MAKEOVER: GETTING OUT OF DEBT

Credit cards are an important part of our financial lives. When used wisely, they are a beneficial tool that helps us establish a positive credit history. They are often the best way (and sometimes the only way) to buy an airline ticket, rent a car, book a hotel room, or make an online purchase. Some cards even give you rewards, such as cash back or airline miles, for using them.

Despite all the advantages and conveniences credit cards can provide, there are pitfalls associated with credit use. Getting into overwhelming debt can be very easy. If a bill isn't paid in full by the due date, finance charges will be added to what you owe, and if you make a late payment or exceed your credit limit, high penalties may be added in as well. Being overextended gets countless consumers into financial trouble every year.

If you are in over your head, don't worry – take action. There are steps you can take to repay what you owe and get back on track.

Create a Budget
Many people use credit cards to make up the difference between what they spend and what they make. The best tool for getting out – and staying out – of debt is creating a budget. The first step is to figure out what you current income and expenses are. List them in the worksheets on the following pages.

Income
When completing the Income Worksheet, avoid overestimating your income. If you work overtime hours, include the extra income only if you are absolutely sure that it will continue. It is always best to use conservative figures. You may not be able to (or want to) work those hours in the future. Bonuses can also problematic when estimating income for the purposes of a budget – include them only if they are guaranteed.

If you are self-employed or your income fluctuates because of commissions or seasonal work, you may have some challenges precisely estimating your income. In this case, you may want to use the previous year's income as a base and estimate whether you think you will be earning more or less. Again, be conservative. It is better to have money left over than be caught not being able to meet your expenses.

Warning Signs of Credit Trouble

If any of these potential warning signs of credit trouble sound familiar to you, it may be time to change your financial habits:

- Paying only the minimum amount due on your credit cards.
- Charging more each month than you make in payments.
- Using credit and cash advances for items that used to be purchased with cash, like gas and groceries.
- Having a total credit balance that rarely decreases.
- Being at or near your credit limit and applying for new cards.
- Needing a loan to pay existing debt.
- Not knowing the total amount that you owe.
- Experiencing feelings of anxiety and stress whenever you use your credit cards.
- Draining your savings to pay debt.
- Making bill payments late.

Continue to next page for Income Worksheet>>

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Income Worksheet

Source	Gross	Net
Job		
Spouse's job		
Part-time job		
Rental/room & board received		
Commissions/bonuses		
Tax refunds		
Investment income		
Government benefits		
Unemployment insurance		
Child support/alimony		
Support from family/friends		
Other		
Other		
Other		
Total Income		

Expenses

It can be time-consuming to analyze all of your expenses, but it is important to be as accurate as possible. Underestimating can mean a shortfall that winds up on your credit cards. Some expenses, such as a car payment, are fixed, while others vary. Little expenditures, like coffee and snacks, can add up to a lot, but are hard to estimate if you don't keep track of them. Taking the time to write down all of your purchases for at least a month can help you come up with accurate figures. To calculate a per month amount for variable expenses, total up what you spend for the year and divide by twelve.

Don't forget about savings. Not only do you want to save for specific goals, like retirement, but it is a good idea to establish an emergency savings fund as well. Life is unexpected, and having three to six months worth of basic living expenses set aside in a savings account can enable you to bounce back from a crisis without having to rely on credit cards. Set a target date for having this safety net in place, and factor the monthly amount needed into your budget.

Note: You do not need to list your debt payments in the Expenses Worksheet because you will be listing them later.

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Expenses Worksheet

Essential Expense	Current	Proposed	Discretionary Expense	Current	Proposed
Rent/mortgage			Internet access		
2nd Mortgage			Movies/video rentals		
HOA (association dues)			Cable/satellite		
Property taxes			Dining out		
Homeowner's insurance			Sports/hobbies/clubs		
Renter's insurance			Gym		
Gas/electric (average)			Storage fees		
Water/sewer/garbage			Vacations/travel		
Telephone			Books/music/dvds		
Home maintenance			Clothing purchases		
Groceries			Laundry/dry cleaning		
Household items			Beauty/barber		
Health insurance			Pool/hot tub service		
Prescriptions/doctor visits			Gardening		
Car payment #1			Monitored alarm		
Car payment #2			Gifts/cards		
Gasoline			Cell phone/pager		
Maintenance/repairs			Banking fees/postage		
Auto insurance			Cigarettes/alcohol		
Auto registration			Religious/charity		
Tolls/parking/mass transit			Pet care		
Daycare/babysitting			Other		
Alimony/child support			Other		
Tuition/lessons			Other		
Student loans			Other		
Taxes (monthly repayment)			Other		
Life insurance			Other		
Union dues			Other		
TOTAL			TOTAL		

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Debt
Now it is time to confront your debt. Use the form below to list your creditors and add up your balances. By knowing how much you owe, you'll be better prepared to commit the funds necessary to become debt free.

Debt Worksheet

Creditor Name	Interest Rate	Monthly Payment	Balance
1			
2			
3			
4			
5			
6			
7			
8			
9			
10			
11			
12			
13			
14			
15			

The Bottom Line
After you have listed everything, subtract your expenses and debt payments from your income. If the result is positive, congratulations – you're on the right track. If it is negative, you will need to take action and increase your income and/or decrease your expenses to tackle that obstacle.

Bottom Line Worksheet

Monthly Net Income	Total Essential Expenses	Total Discretionary Expenses	Total Debt Payment	Balance
	–	–	–	=

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Controlling Spending Urges
In order for your budget to be helpful, you need to follow it! That can be easier said than done when you are standing in front of a shiny new item in a store. The following are some tips on how to controlling spending urges and prevent the overuse of plastic:

In places where you are worried you will overspend, leave your debit and credit cards at home and just bring cash. You cannot spend more cash than you have.

Avoid shopping as a social activity. It is easy to get sucked into the excitement of buying something when you are with a friend.

For each potential purchase, ask yourself if the item is essential. If it is not, wait 24 hours and see if you still want it.

Allow yourself to have small, affordable rewards for sticking to your budget. Budgeting is like dieting – if you don't leave room for any indulgences, it will be hard to stick with it.

If all else fails, cancel your credit cards. Having and using credit responsibly is essential to having a good credit score. But if you are unable to control your credit usage, it may be better to close the cards and take a hit to your score than get further into debt.

Delete Your Debt
Creating a budget can help you avoid getting into debt in the future, but what about the debt that you have now? Having debt can not only absorb a significant portion of your income each month but also cost you thousands of dollars in interest payments. Conversely, paying off your debt can provide a feeling of relief and give you more money for other things, like savings.

There are two basic methods of accelerating debt repayment. One is to increase your payments. Minimum payments are often set very low, so it could be years before you are debt free if that is all you pay. If you have multiple accounts, you will save more money by being systematic and focusing your extra payments on one creditor at a time instead of sending a little extra to all of your creditors. (Of course, you should continue to make minimum payments to everyone.) Many people like to start with the debt with the lowest balance because it will be paid off the soonest, providing gratification that makes it easier to keep going. However, you will save the most money by starting with the debt with the highest interest rate. Once the first debt is paid off, put that money toward the debt with next lowest balance or highest interest rate and so on until all of your accounts are paid off.

The other method is to lower your interest rates. There are several ways that you may be able to get lower interest rates, including:

Asking the creditors directly to lower the interest rates. Creditors are usually more willing to do this if you have made your payments on time. Of course, they may still say no, but it does not hurt to ask.
Transferring your balances to a card with a lower interest rate. (However, as discussed later, doing this often can hurt your credit score.)

Getting a consolidation loan. Whether you can get one will depend on your credit score, income, and current level of debt.

Paying off existing debt with a home equity line/loan or cash out refinance (where you refinance your mortgage for more than you owe): The interest rate is usually lower than for other debt, and the interest is tax deductible. However, it is important to remember that you are increasing your mortgage payments, and you will lose your home if you cannot make them.

Participating in a Debt Management Plan, in which creditors offer lower interest rates in exchange for going through counseling and closing your accounts.

If you are thinking about a balance transfer, consolidation loan, home equity line/loan, or cash out refinance, remember that you are using debt to pay off debt. If you start using and carrying a balance on old cards, you are actually increasing your level of debt, not decreasing it. These options work best if you are committed to not taking on more debt.

These two methods of accelerating debt repayment are not mutually exclusive. In fact, it is a good idea to try to increase your payments and lower your interest rates at the same time.

Improving Your Credit Standing
All of your credit activity is tracked by your credit report, which is compiled by three credit bureaus: Equifax, Experian and TransUnion. For each credit card, loan, and/or other credit account that you have, your report shows who it is with, your payment history, the initial amount borrowed (for loans) or credit limit (for revolving credit, like credit cards), the current amount owed, and when it was opened/taken out. Your report also shows if you have experienced any credit-

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related legal actions, such as a judgment, foreclosure, bankruptcy, or repossession, and who has pulled your report (called an inquiry).

Your credit score is a numeric summary of the information in your credit report and is designed to predict the likelihood that you will repay what you borrow. The most commonly used scoring model is the FICO score, which ranges from 300 to 850, with a higher score being indicative of less risk. Generally, those with a higher score are more easily granted credit and get a better interest rate. While there is no standard for what constitutes a "good" credit score, one benchmark to keep in mind is that many mortgage lenders require a score of at least 620 for approval and 760 for the lowest interest rate.

The following are the factors that are used to calculate your FICO score:

- Payment history (35%): Making your payments on time boosts your score. Conversely, if you make a late payment, your score will take a hit. The more recent, frequent, and severe the lateness, the lower your score. Collection accounts and legal actions have a serious negative impact.
- Amounts owed (30%): Carrying large balances on personal loans and revolving debt, like credit cards, particularly if those balances are close to the credit limits, will lower your score.
- Length of credit history (15%): The longer you have had your accounts, the better.
- New credit (10%): This factor looks at the number and proportion of recently opened accounts and the number of inquiries.
- Types of credit used (10%): Having a variety of accounts, such as credit cards, retail accounts, and loans, boosts your score.

If your score is less than stellar due to getting into debt, don't despair. By practicing good credit habits, you can raise your score over time:

- Always pay on time. Your payment history makes up the largest chunk of your credit score, so making your payments on time is extremely important.
- Reduce your debt load. Even if you have never missed a payment, a large debt load will lower your score. Commit to repaying your debt as soon as possible and, in the future, not charging more than you can pay off in full the next month.
- Check your credit report for errors. Many reports contain them, and they can lower your score. You can get a free copy of your report from each bureau once a year from the Annual Credit Report Request Service (www.annualcreditreport.com, (877) 322-8228). If you notice any errors, send a dispute letter to the relevant credit bureau(s).
- Keep your old accounts. A long credit history with the same accounts indicates stability.
- Limit balance transfers. While transferring balances to "teaser rate" cards can be a way to efficiently get out of debt, it can also have a detrimental effect on your credit score. The accounts will be new and likely have balances close to the limit to maximize the advantage of the low rate – two factors that lower your score.
- Avoid excess credit applications. Every time you apply for credit, your score decreases just a bit. If you do it frequently, a creditor may see it as a sign that you need to rely on credit to pay your bills.
- Be patient. It may feel like credit mistakes can haunt you forever, but your payment history from the past two years is more important that what happened before that, and most negative information is removed from your report after seven years.

Regardless of what your financial situation looks like now, remember, with dedication to budgeting and wise credit management, you can be debt free, have a good credit score, and achieve whatever other financial goals you desire.

Schedule your private one-on-one for personalized financial tips today!

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