Debt Management

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What is debt management?

As a modern consumer, you need credit. When you were growing up, you may have heard your parents or grandparents say, "If you can't pay for it with cash, then you can't afford to buy it." That may have been sound advice 40 or even 20 years ago, but such attitudes about credit are outdated and unrealistic for most adults working and living in modern times. The average cost of a car, house, or college education has skyrocketed when compared to the average household income, so typical consumers need to borrow money if they want to buy a home, drive a car, or educate themselves or their children. Throw in a handful of charge accounts and credit cards, and it is no wonder that the average consumer is carrying more debt than ever before. With greater credit needs comes a greater need for debt management.

Good debt management ensures that you will have credit when you need it, make wise borrowing decisions, and avoid disaster if you become overextended. You can ensure that loans are available when you need them by establishing and maintaining a positivecredit record. You can benefit from many specialized loan programs if you are aware of yourborrowing options. You can save money by taking steps toreduce the cost of debtand save yourself from disaster if you know what to dowhen you can no longer meet your financial obligations.

Establishing credit

You must firstestablish a credit recordif you want to have ready access to loans when you need them. You establish a credit record by borrowing money from a lender who reports to a credit bureau. So, what's the problem? The problem is that few lenders will loan you money if you don't have an established credit record. That is the catch-22 of building credit. However, if you have no credit experience, there are several ways to get started.

Thinking small and taking advantage of special credit deals is one way to establish that first credit relationship. Increasing lender confidence with a large down payment, or posting collateral, is another. Insured credit, guaranteed credit, and secured credit help many borrowers get started. If you pay your obligations as agreed, you will be surprised at how many lenders will offer you credit once the ball is rolling.

Borrowing options

You wouldn't try to buy a house using proceeds from astudent loan, nor would you try to finance your college education with a credit card. However, you might use ahome equity loan or line of creditto finance your child's college education. Knowing what borrowing optionsare available to you is important when shopping for credit. Some types of loans carry lower interest rates, some have tax-deductible interest, some are subsidized by government entities, and still others have special repayment terms designed to serve the needs of a special class of borrower.

Whenever you have the need to finance an expense, it is worth your time and effort to educate yourself about your borrowing options. Lenders today are enormously competitive, and there are more than just interest rates to consider when comparing one loan package to another. Find the loan that best suits your needs, and be sure you have examined all your choices.

Credit reports

Part of what makes it possible for you to shop for credit is yourcredit report, which is a record of your past credit relationships. As mentioned previously, establishing and maintaining a good credit record makes you an attractive customer for lenders. You will get the best deals and have access to the largest number of credit options if your good credit record is maintained.

The first step in maintaining a good credit record is to pay your obligations as agreed. However, merely paying your bills is not enough. Many credit reports contain errors that are clerical in nature or caused by misidentification (e.g., someone else's bad credit gets put on your report). Although these errors are not your fault, they can cause delay or rejection when applying for a loan. To avoid such complications and delays, you needto obtain copies of your credit reportsfrom the various national credit reporting agencies. Once done, you need tointerpret the informationand determine whether errors have been made. If there are problems with your report, you have specificrightsthat you can exercise and a procedure forcorrecting errors. You can force the credit reporting agencies to investigate errors and either correct, confirm, or delete the information, usually within 30 days.

Repairing poor credit

If the information on your credit report is correct but bad, you face a more difficult task. However,a poor credit record can be improved. Adding good credit to your report is helpful. It shows that your period of financial difficulty is over and that you are once again making good on your debts. You can also go back to creditors that reported bad information and negotiate a deal in which you agree to pay off the account, or make additional payments on the account, if the lender will agree to upgrade your credit status.

Your report may contain bad credit because of a dispute with a creditor. Perhaps you purchased a defective appliance on credit, the merchant failed to repair or replace it, you refused to make payments, and the merchant reported you as delinquent. You can add a consumer statement to your credit report to tell your side of the story. If all else fails in your attempt to repair credit, you may have to simply wait out your credit problems. Even bankruptcies disappear from your report in time.

Reducing the cost of debt

It is good to periodically evaluate your debt situation and determine whether you canreduce the cost of debt. It makes no sense to be paying more money for interest if you can be paying less. There are several ways to reduce the cost of debt: You can refinance loans to get lower interest rates, use the equity in your home to pay off high interest loans and credit card balances, or transfer your credit card balances to cards with lower rates.

Other options include prepaying debts and liquidating assets to pay off loans and to avoid further interest charges. You may also seek to reduce or eliminate noninterest costs related to borrowing, such asprivate mortgage insurance (PMI). If you have kept your mortgage payments current and built up sufficient equity in your house, you may be able to cancel your PMI coverage. Many of these options have tradeoffs. For more information, see a financial professional.

Options when you can't meet your financial obligations

Ideally, you should never incur more debt than you can afford. If that plan fails, then your next task is to recognize when you are financially overextended and do something about it. Doing nothing is the worst possible choice. The longer you wait to take action, the more severe your financial troubles are likely to become.

Increasing your income streammay be an option. If not, there are things you can do to reduce your monthly obligations.Reducing the cost of debt, or negotiating directly with your creditors may enable you to lower monthly payments. If you need professional advice, you can hire acredit counseloror contact one of the many nonprofit credit counseling services, such asConsumer Credit Counseling Services, which can often arrange an affordable repayment plan for you. If things are really out of control, you may want to consult an attorney aboutbankruptcyand determine whether you would benefit from a self-help support program such as Debtors Anonymous. You should face up to your financial difficulties and take steps to resolve them.

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