MONEY MATTERS — Tax and financial planning strategies

Lightening the debt load

By Mike Slotopolsky

THERE ARE TWO TYPES OF PEOPLE – those who live with debt and those who don't. There's never really any question which group you fit in. It's pretty black and white. There are those who pay off their monthly bills in full and would never think of buying something which would put a dent into that thinking. Others pull out any one of a dozen credit cards to buy what they want when they want it, paying the minimum balance when the first of the month rolls around. The folks in this group live with immeasurable stress as mountains of debt pile up and think there's no way to dig themselves out of this black hole.

Getting out of debt may not be as difficult as you think. It's often easy to be overwhelmed by what seems like a mountain of debt, but making a few smart moves at the right time can lead to financial freedom.

Most aren't even sure how to go about doing that. In theory, no one wants to live with debt, but in practice people don't know how to reduce the load. This column isn't about the psychology behind debt although that's certainly something to figure out or you're doomed to repeat the same financial mistakes. I'm more interested in exploring a few failsafe ways to reduce your debt.

First things first. You've got to be willing to make sacrifices and stick to a budget. It's time to be conscious of your buying habits. It's time to tear up all of your credit cards. It's going to be difficult enough paying off what you've already accrued; adding to that debt will just help you sink quicker. Like an alcoholic who has to go cold turkey to get on the path of sobriety, the excessive spender must stop all unnecessary purchases including that $4 morning coffee and $10 lunch. It's time to start brown bagging it. Don't allow yourself any wiggle room for unnecessary purchases as your 20% interest rates compounds.

When/if you're able to do this first step, now's the time to pay off the credit cards with more than just minimum payments. Paying the minimum two or three percent is exactly what banks want you to do because that's how they make their money. You have to pay as much as you possibly can. Try doubling whatever you've been paying. Do this for three months; if you can swing it, add another 10% to the pay off.

Know how much interest you're paying and negotiate a better rate. If your credit card company won't work with you, find another company that offers a lower interest rate or that offers to consolidate all of your debt into one line of credit. Similarly, you can borrow from a bank at a lower interest rate to pay off all your credit cards, leaving you with just one monthly payment at a lower interest rate. If you have many credit cards with balances that carry similar interest rates, pay off the account with the lowest balance first. This is snowballing. When you finish paying off one card, rip it up and move on to the next. As debt decreases, you'll have more money to pay the next debt.

It may be smart to use savings or investments to repay debt. You'd generally have to make more than 18% interest for this option to be ineffective and chances are you're earning less than 18%. If you have a life insurance policy with a cash value, you can borrow against it. The interest rate is probably low. Make sure you pay it back before you die though or the outstanding value plus interest will be deducted.

I'm not a big believer of borrowing from Peter to pay Paul, but sometimes you have to. Consider taking out a home equity loan (HEL) for the maximum amount. Pay off all your 18% interest debt at just six or seven percent. If you itemize deductions on your tax return, HEL is deductible which can save you another one or two percent. Now here's why I don't like this idea. Most people pay off their debt and then start accumulating debt all over again. Now they have to pay the credit card debt plus they have the substantial HEL debt which puts them in, you guessed it, HELL. New debt, deeper hole, and it's happening all over this country.

Another option which I'm not even open to discussing is bankruptcy. You got yourself into whatever debt you're swimming in so now it's up to you to start dog paddling yourself out of it. And that requires a great deal of sacrifice and commitment, a couple of words far too many among us have been unfamiliar with for too long. ❑

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