focus

FEDERAL CREDIT UNION

DEBT MANAGEMENT

Understanding your debt and knowing how to get out of it is key to a secure financial future.

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Introduction

One of the worst things about being in debt is the risk it brings to your life. Living with debt can be a source of physical and mental setbacks. Studies show people with debt are more likely to have mental health concerns. These concerns include anxiety, depression, panic disorders, insomnia, and even excessive alcohol or drug use.

If you're in debt, it's unlikely you have an emergency fund to fall back on if something happens. Not having a safety net can put you at risk if you have a setback like losing your job or a medical crisis.

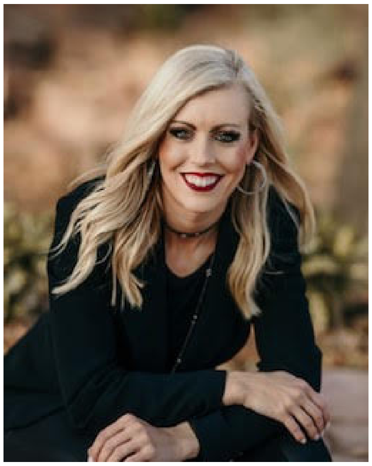
Being debt-free gives you room to breathe. You don't have to worry as much about a single event ruining your financial life.

Knowing how to tackle your debt has financial, physical, and mental health benefits. This ebook is a guide to helping you understand your debt and ways to work toward a more stable financial future.

In this e-book, you'll learn:

- The definition of debt
- Differences between good and bad debt
- How to understand your credit history and credit score
- How to tackle your debt
- How to stay financially fit

About Abigail Cabello



Abigail Cabello is the community development officer at Focus Federal Credit Union in Oklahoma City. She received her bachelor's degree from the University of Central Oklahoma in Edmond, Oklahoma, focusing on marketing and professional sales.

Having worked in several positions at Focus Federal Credit Union for almost seven years, Cabello has extensive knowledge of the industry, from consumer loans to business development. She facilitates financial wellness seminars for partner companies and nonprofits alike, focusing on financial "hot topics."

Cabello is active in six chambers of commerce in her branch-area locations, and serves on the board of directors for the NW OKC Chamber of Commerce. Helping others in her community financially is her passion. She considers it a great accomplishment to see her members achieve financial stability.

Chapter 01 What is Debt?

Understanding different debt obstacles and how they impact your financial situation

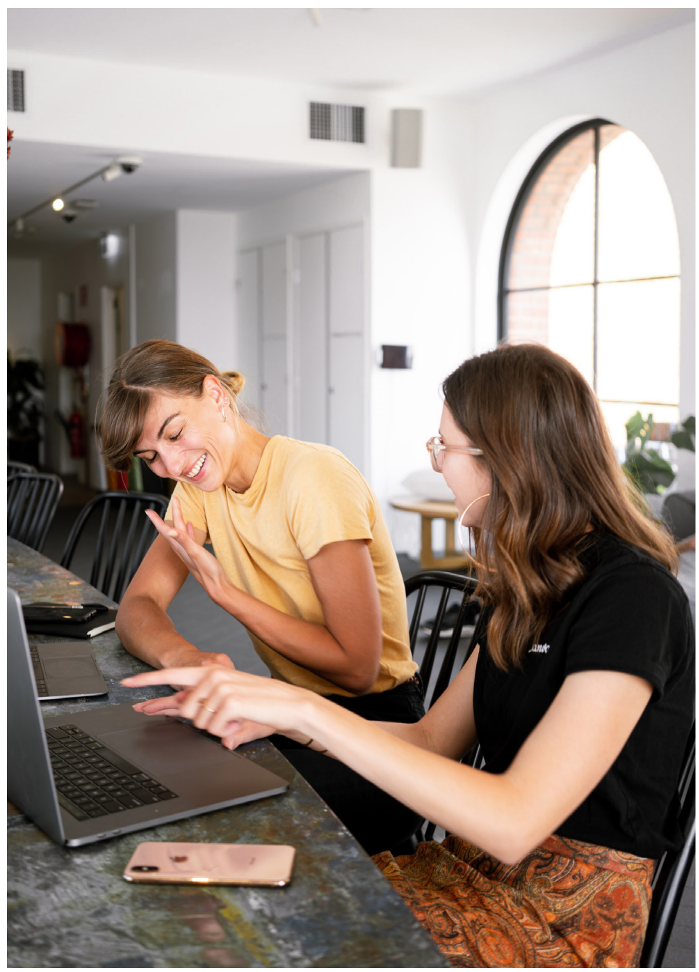
What is debt? The short answer is that debt is money you borrow with an understanding that you'll repay it.

The average American has more than $90,000 in debt in 2021. This debt is despite most Americans increasing their income by almost 4% annually. Americans continue to make more money and have more debt. Why? It has to do with people's financial literacy. People don't have a good grasp of how to manage debt and control their financial picture.

While debt comes in several forms, you categorize all personal debt in four categories:

1. Secured debt
2. Unsecured debt
3. Revolving credit
4. Installation credit

You need to know the difference in the four types of debt when borrowing money and prioritizing debt repayment.



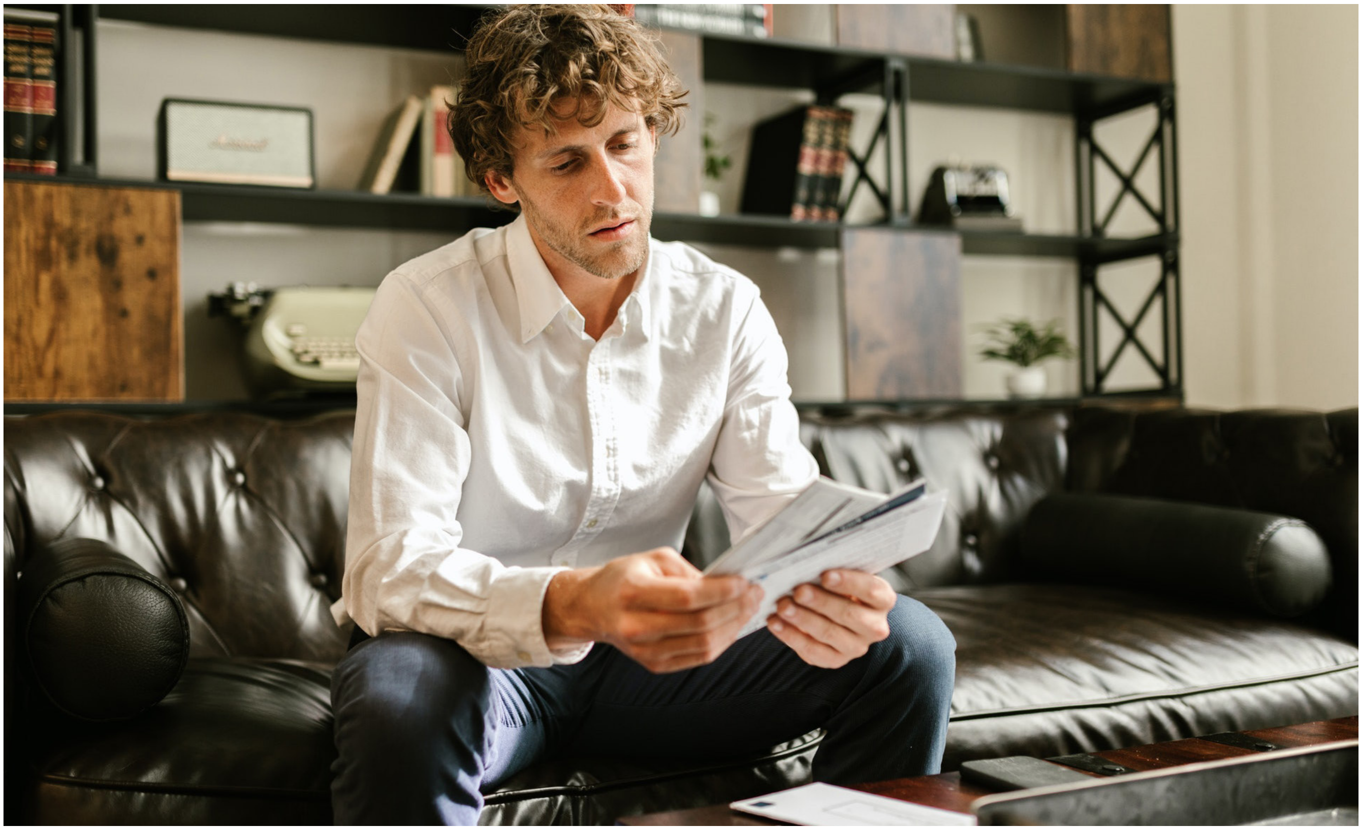
Secured vs. Unsecured Debt

You back secured debt by an asset such as a house or car. The asset is considered collateral for the debt. When you take out a loan, the lender places a lien on the asset. It gives them the right to seize the property if you don't pay the debt. For example, you secure a mortgage loan with a home. You secure a car loan with a vehicle.

Unsecured debt is not backed by collateral. If you fail to make payment, the lender can't make claims to assets, but they can take other actions to recoup the money. Unsecured debts are things like personal loans, medical loans, and credit card debt. This debt has higher interest rates and less favorable terms, especially for those with bad credit history.

Installment vs. Revolving Credit

When you take out debt, you can pay it back in installments or through revolving credit. Installment credit offers a borrower a fixed amount of money over a specified period. The borrower knows up front the number of monthly payments they need to make and how much each monthly payment will be. The loan period can last months or years, depending on the terms of the loan. A borrower can choose smaller monthly payments over an extended period or larger payments in a shorter time.



The ability to choose your repayment schedule is a helpful feature of an installment loan. A mortgage, car loan, or student loan are examples of installment debt.

With revolving credit, your credit line has no predetermined end time. You can spend up to your limit repeatedly. Credit cards are the most common revolving credit. Cardholders make charges and then pay them off in full or partial payments. The amount of money you use, within their credit limit, is up to you. There is no set monthly payment plan. Cash advances are another example of revolving credit.

Fixed vs. Variable Interest Rates

When taking out a loan, you should understand the interest rate and how it impacts what you pay back. The interest rate is a percentage of the principal. It is fixed or variable.

A fixed interest rate means the rate stays the same for the entire borrowing period. A variable rate fluctuates over time in response to changes in the market.

Mortgage and car loans usually have fixed interest rates. On the other hand, credit cards and payday loans offer variable rates.

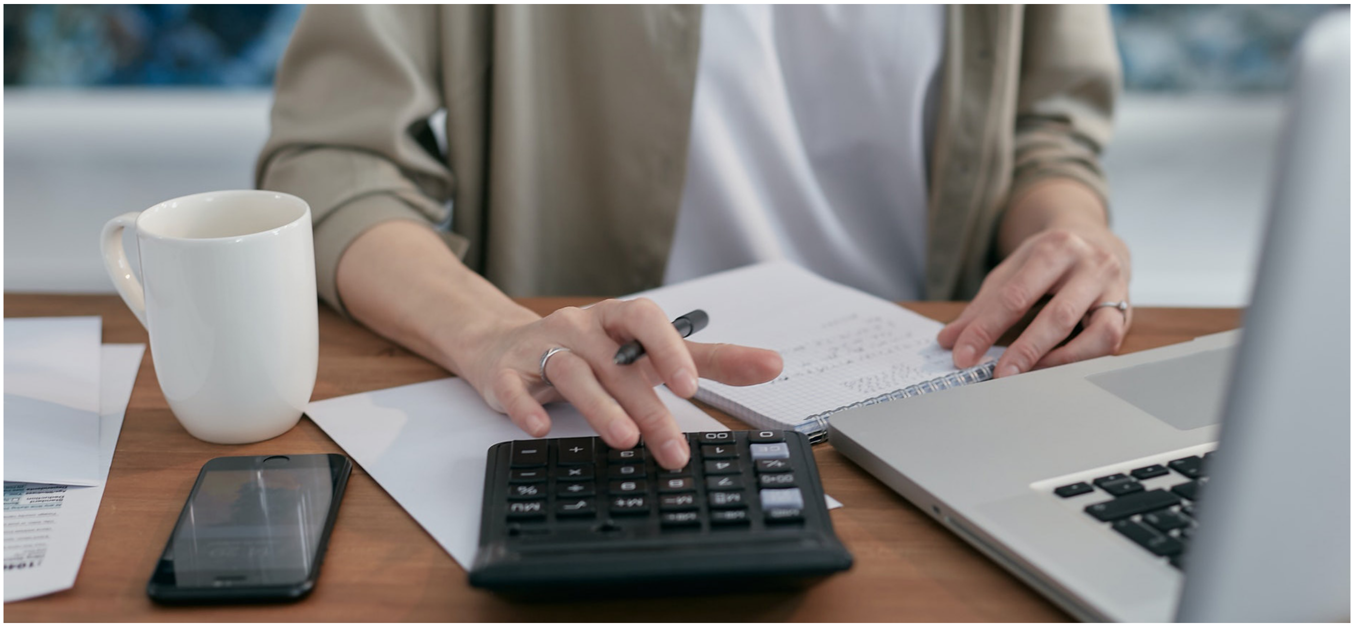
Variable interest rates are tempting because they are typically lower in the beginning than a fixed rate. They're also a riskier choice because rates tend to increase during the course of the loan. You should be aware of the potential risks associated with variable interest rates.

KEY TAKEAWAY

Understand the different types of debt you have and the interest rates you pay.

Chapter 02 Good vs. Bad Debt

Most people get into debt because they're not thinking about the actual cost of borrowing money.



Not all debt is bad. Good debt can be an investment. In general, if you spend money on something that increases your assets, such as a house, or enhances your net worth, like a student or small business loan, then creditors consider it good debt.

Bad debt doesn't increase your wealth and has no lasting value. An example of bad debt is taking out a personal loan for a vacation or luxury item. Creating debt because of wants over needs can be dangerous for your financial stability.

A good indicator you have taken on too much debt is to calculate your debt-to-income ratio. This figure is the ratio between the amount of your recurring monthly debt, such as your mortgage, auto loan, and credit card payments, and your gross monthly income. Most lenders consider you overextended when your debt-to-income ratio is more than 36%.

Another red flag is credit card balances exceeding 10% of your income. If you earn $50,000 a year and have more than $5,000 on a credit card, you hamper your ability to respond to a crisis. Let's look at credit card debt and how it can quickly put you in a difficult financial situation.

The average credit card interest rate in 2021 is 16% APR. If you owe $5,000 in credit card debt and only pay the 2% minimum payment, the credit card company adds $67 in interest to your balance each month. If you didn't use the card and continued to pay the 2% minimum every month, it would take more than six years to pay off. You would pay $8,294, including $3,294 in interest, to pay off what started as $5,000 in debt.

When you are considering taking on debt, ask yourself:

- Can you afford it? This question goes beyond simply making the monthly payment. You need to consider all other factors, such as the opportunity costs?
- What will you give up to make this purchase?
- Is taking on the debt worth it?
- Will the additional debt hinder your ability to meet other financial obligations?
- Will it prevent you from saving for your future?

Additional warning signs of too much debt are:

- Spending more than you earn
- Skipping payments on certain bills to pay others
- Only making the minimum payment on your credit cards each month
- Paying day-to-day bills with credit cards
- You're unsure about what you owe.
- Creditors call you about late bills
- Living paycheck to paycheck
- You have no money saved for retirement.

These warning signs indicate you're in trouble. You need to reach out to your financial institution or a financial advisor for help.

KEY TAKEAWAY

Always make a plan before you make a purchase. Write things down. Don't make impulse purchases.

Chapter 03 Understanding Your Credit

Understanding your credit score will assist you in making sound financial decisions.

Lenders and creditors report your credit information to credit-reporting agencies, also called credit bureaus. Equifax, Experian, and TransUnion are the three largest credit bureaus. If you use credit, they probably have a record of it.

Information credit bureaus record includes:

- Personal information like your name, address, social security number, date of birth, and jobs
- Outstanding loan details
- Your debt repayment history
- Your credit limits
- Court judgments, including child support payments or lawsuits
- Bankruptcies filed in the past seven to 10 years

Credit bureaus use this information to create credit scoring models that predict how likely a borrower is to pay back debt. Lenders, insurance companies, landlords, and even potential employers use credit scores. The two most popular credit scores among lenders are FICO® Scores and VantageScore.

Your FICO score is from five weighted categories of information. They are:

1. **Payment History (35% of your FICO score).** The single most significant factor determining your credit score is whether you pay your bills on time. Late payments, delinquent accounts, and debt in collections all negatively affect your credit.
2. **Debt Owed (30% of your FICO score).** The amount of money you owe on credit accounts can negatively affect your score. Creditors want to know if you spread your income too thin. Your credit score considers all credit card balances.
3. **Length of Credit History (15% of your FICO score).** A measurement of a variety of time-related factors, including how long you've had accounts open. A long credit history can positively affect your credit, while short one can negatively impact your score.

4. **New Credit (10% of your FICO score).** New credit looks at any accounts you opened and credit inquiries within the past 12 months.
5. **Credit Mix (10% of your FICO score).** They look for your ability to manage multi-accounts such as a mortgage, credit cards, and car loans.

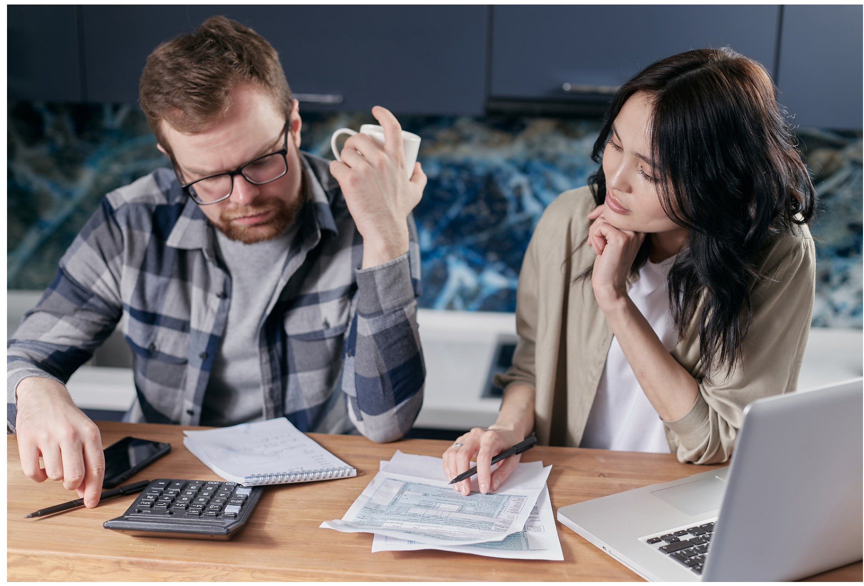
A FICO score of 800-850 is exceptional, 740-799 is very good, 670-739 good, 580-669 fair, and a score below 579 is poor. A perfect FICO score is 850. The average score is 693.

VantageScore prefers not to use percentages to describe how much weight it gives various credit factors. Instead, it describes factors in terms of influence from "extremely influential" to "less influential."

The factors weighed are:

- payment history
- depth of credit
- utilization
- balances
- recent credit applications
- available credit.

A VantageScore of 781-850 is excellent. A score of 661-780 is good. A 601-660 is fair. A 600-500 is poor. Any score below 499 is very poor.

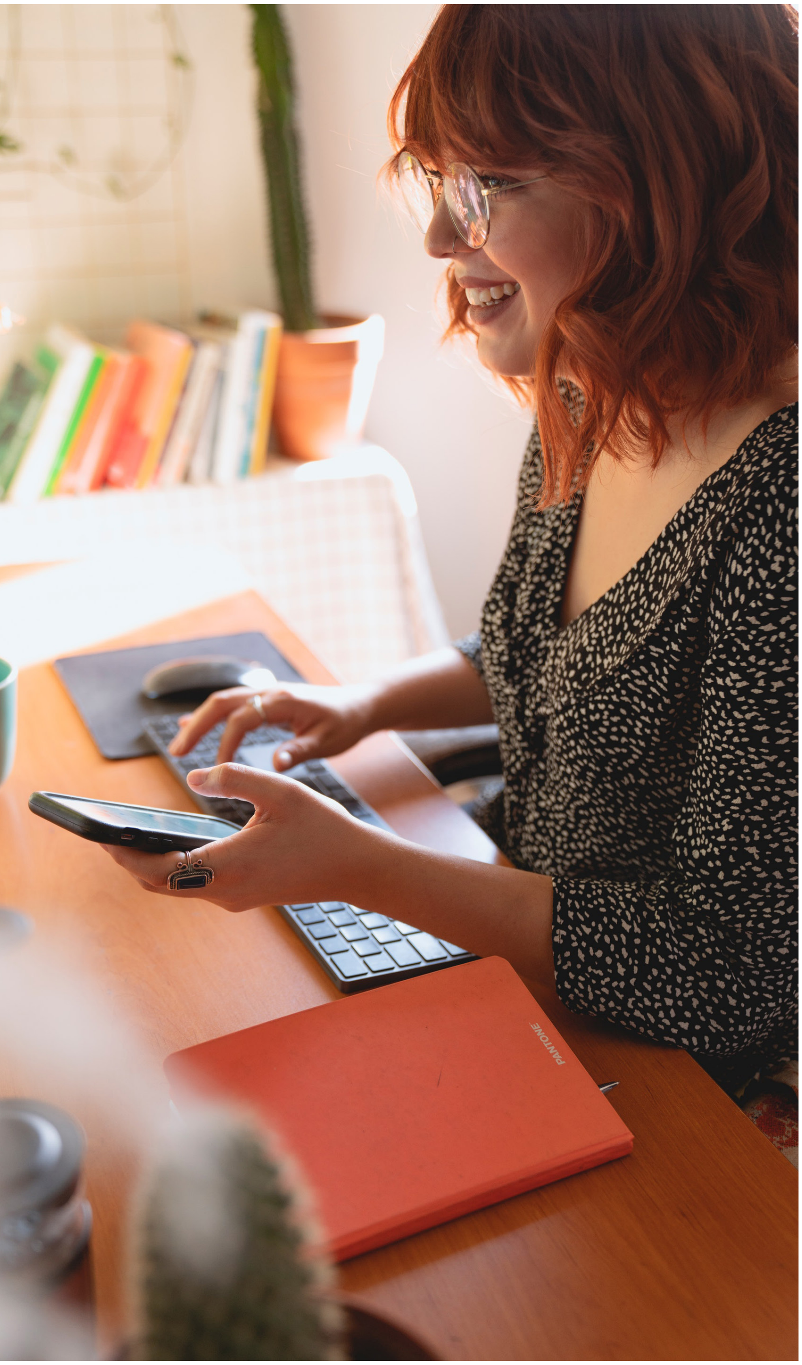


KEY TAKEAWAY

Your credit report contains information on credit history. Potential lenders and creditors use the information to determine whether to offer you credit. They also use it to generate your term agreements.

Chapter 04 Tackling Your Debt

Digging out of serious debt takes willpower and perseverance.



You've got to be committed to making a change, creating an actionable plan, and breaking old habits to get out of debt. It takes determination.

The first step in tackling your debt is getting organized and understanding what you owe. Pull out your credit card bills, bank statements, and tax records for the prior 12 months. It's good to look at a whole year since certain expenses may be annual.

Bucket expenses into two categories, fixed and variable. Fixed expenses don't fluctuate and are consistent either weekly, monthly, or annually. They include things like rent, mortgage, utilities, and insurance. Variable expenses fluctuate and include entertainment, groceries, and dining out.

Document all of your expenses. You'll likely find, especially in the beginning, that you forgot to include things. Just add them to your budget document and make adjustments as you recognize them.

Then figure out what you can cut. View your bank statements and credit card purchases to determine what you spend every month. Determine what items are wants versus needs, focusing on eliminating the wants to chip away at debt.

Some ways to cut spending include:

- **Stop Eating Out.** You need food but look for ways to spend less. Choose to eliminate restaurants and eat at home instead.

- **Comparison Price.** Consumer Reports found store-brand foods and beverages are 20-25% less than name-brand products. You won't even notice the substitution for many products, but you'll see the difference in your grocery bill. Pay attention to the unit price. Buying a larger container can save you more in the long run.

- **Use Coupons.** Discounts are available if you're willing to look for them. There are a lot of couponing blogs to follow. Sign up for their email newsletters. They'll tell you all the coupon finds you can cash in on.

- **Cancel Subscriptions.** Multiple streaming services such as Netflix, YouTube TV, Apple TV, and Disney+ all add up. Certain providers charge for adding devices on top of their monthly subscription fee. Cut back a service or eliminate multiple device charges.

- **Cancel Unused Membership.** Consider dropping your gym membership to work out at home. Also cancel monthly box and magazine subscriptions.

- **Buy Used.** When you do need to buy something, look at used options first. From clothes to sports equipment to furniture, there are many online services and consignment stores to consider.

- **Stop Impulse Buying.** If you don't need it, don't buy it. Impulse buying adds quickly to your debt.

- **Make a "Free Fun" List.** Paying off debt can be a long, tumultuous process. While it may not directly affect your debt pile, making time to have fun will improve your quality of life. It also will help keep you on track. Research when local museums offer free admission days, see what free concerts and festivals are happening in your community, and find local businesses offering free demonstrations.

One of the most frustrating things about debt is that the debt still grows because of interest, even if you've stopped spending entirely. Look for ways to cut interest rates on outstanding debt. Call your credit card company and ask if they can lower your interest rate. It may not happen, especially if you have late payments or high balances, but it's definitely worth the call.

Another option is to transfer a portion of your high-interest debt to a card with a lower interest rate. This rate is ideally a low fixed rate or a promotional 0% interest rate. But you should know that opening another credit card account will temporarily lower your credit score. If you don't pay off the transferred balance by the end of the promotion, you're back with a high-interest rate.

Cutting back is beneficial to reducing your debt. But if you can combine it with increasing your income, you'll reduce your debt faster.

Here are some ways to increase your income:

- **Ask for a Raise.** It's difficult to ask for a pay increase. But when it's time for your annual evaluation, ask how you could increase your pay. If you receive hourly payment, consider taking extra shifts or working overtime.
- **Get a Part-time Job.** Working a full-time and part-time job can be rough, but many people do it to pay off their debt. Look for a position near your home or regular job to make your commute faster and cheaper.
- **Get a New Job**. If you're stuck at your current pay rate at your job, consider whether it's time for a change. Update your resume and spruce up your LinkedIn profile. Consider learning a new skill or certification to increase your chances of getting hired.
- **Take on a Side Gig.** A side hustle is a great way to make extra money in your spare time. Pet sitting, food delivery, or delivery driving are all possible options
- **Sell What You Don't Need.** Consider taking clothing, shoes, and accessories you don't use to a consignment shop. List used textbooks, books, and DVDs on Amazon. You can sell anything else you no longer use on eBay, Facebook Marketplace, or during a weekend yard sale.

Now that you've determined things you can cut out and ways to increase your income, you can put that money toward debt.

There are different ways to pay down your debt. Financial guru Dave Ramsey popularized the snowball method to get out of debt. It involves focusing on paying off the smallest debt first, then working on the next-smallest debt until they're all paid off.

Here's an example of how the snowball method might work. Say you squeezed an extra $500 out of your budget to channel toward paying down debt.

For this example, you have the following debts:

- $1,500 personal loan; minimum payment $50
- $7,000 car loan; minimum payment $200
- $9,000 credit card debt; minimum payment $225
- $18,000 student loan; minimum payment $300

In this scenario, the snowball method has you pay just the minimum payment on all debts except for the smallest. Then, you'd put the extra $500 toward quickly paying off the personal loan. Once you paid the personal loan, you'd take the $550 you were paying toward the It and add it to the $200 you pay for the car loan. So now you're paying $750 toward your car loan, and gradually you're paying debts off.

KEY TAKEAWAY

Keep your focus on the big picture when making everyday money choices. Constant budgeting, ongoing financial education, and planning enable you to tackle your debt.

Chapter 05 Staying Out of Debt

The process of becoming and remaining debt-free is continuous.

It’s essential to stay focused and on track with your financial goals. One of the most important actions you can take to control your finances is to create a budget. You need a way to track the money you bring in, compared to the money going out.

Implement a system for paying bills. Create a document on your computer to help you keep track of what bills you paid. And when you make a payment, include the date you paid and the confirmation number if you’re paying online.

Computer software programs and apps help you develop and track your budget. Many of these programs also let you tag and categorize your spending.

If you’re more of a pencil and paper person, that’s fine too. Include as much information as you can and review your budget regularly.

You’ll also want to:

- **Update Your Accounts**. Update your email address on all of your accounts. Updating ensures you get all of your notifications from lenders, your credit union, and creditors.
- **Set Up Alerts.** Set up alerts so you get quick notification if there are fraudulent charges or updates to terms.
- **Create a Bill Calendar.** Create a visual of when each bill is due. Post the calendar in a predominant area, and cross it off when you pay the bill.

Once you pay off your debts, it's essential to keep the momentum. You want to take steps to ensure you stay out of debt in the future.

Steps to stay out of debt include:

- **Set Up an Emergency Fund**. The amount you want to have available varies per person, but experts recommend having at least $1,000.
- **Plan for Periodic Expenses.** It's easier to budget for monthly bills. But don't forget occasional expenses like gifts, car repairs, home maintenance, and vacations.
- **Live within Your Means.** Don't use credit as an extension of your income.

It also will help you with financial security if you establish SMART financial goals. SMART goals are:

- **Specific**. Pinpoint something you want to change to achieve. For example, I want to set up an emergency fund.
- **Measurable**. You want to measure your goal. For example, I plan to save $3,000 for the fund.
- **Achievable**. Something you can accomplish. Setting goals too high can lead to frustration. For example, I will reach my $3,000 by saving $250 per month.
- **Realistic**. Goals should be realistic based on factors like your income, time, and what you can do. For example, I will cancel my cable subscription and gym membership. I also will eat out less to help me save.
- **Time-Oriented**. Set milestones and schedules for your goals. For example, It will take me 12 months to save $3,000.

A financially fit person prioritizes savings. Savings is a fixed item on their monthly budget. It's not something that only happens if there's money left over. Prioritizing savings allows them to think ahead and build a comfortable nest egg or an emergency fund. In turn, a robust safety net means knowing there's money to cover unexpected expenses or changes in circumstances.

You'll also want to work to boost your credit score. Since your credit score is a mix of multiple factors, it takes a mix of behaviors to improve it.

Here are some ways to improve your credit score:

- **Pay Bills on Time.** Set up bills to automatically withdraw your monthly payments from your bank account.

- **Check for Errors**. One in five consumers has a mistake on their credit report. You can have your credit report pulled annually at no charge by Equifax, Experian, or TransUnion. If you notice errors, follow the process for disputing credit report errors. Correcting the report is an easy way to improve your score.

- **Research a Secured Credit Card.** If you can't open a regular credit card, open a secured credit card account. Secured credit cards are easier to get than most credit cards because you have to make a security deposit.

- **Lower Credit Usage.** Lower the amount of your credit you're using. A ratio of less than 10% positively impacts your credit score. More than 30% hurts your credit score.

- **Avoid Closing Accounts.** Lenders want to see a history of responsible money management. Access to credit and a long credit history boost your overall credit score. Keep accounts open even if you no longer use them. Closing credit accounts reduces your access to credit and raises your credit ratio. If you worry about spending, leave the account open, but cut the card up or lock it in a secure place. Check to make sure your credit card company won't close your account if you don't use it. One exception is if you have a credit card that charges an annual fee, even if you aren't using it. Close any accounts costing you money and use the savings to pay off debt.

KEY TAKEAWAY

A financially fit person is committed to paying down debts and seeks to live debt-free.

Chapter 06 Conclusion

Getting out of debt can help to eliminate the many physical and mental problems people in debt face.

But getting out of debt can be overwhelming. It's important to get help.

Your local credit union, credit counselors, certified financial planners, accountants, and attorneys are all resources you can turn to if you are struggling financially.

Being afraid to reach out to these resources can hold you back. Keep in mind that, by contacting them, you are taking ownership of your finances.

Work with Focus Federal Credit Union

Focus Federal Credit Union wants to work with you and help you become debt-free and financially stable. Schedule a time to talk with one of our representatives. We'll work on building you a solid foundation together.

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