SHRINKING A MOUNTAIN OF DEBT, ONE PIECE AT A TIME

Debt is something you will probably have to deal with at some point. The size of that debt may range from owing the price of some new clothes to a mortgage on a house. Whatever the case, knowing how to handle personal debt is important in maintaining healthy finances over the long term.

Are You in Too Much Debt?

To evaluate your debt situation, start by asking yourself these questions:

- Is my credit card balance growing?
- Am I paying only the minimum on my bills or am I missing payments altogether?
- Do I spend over one-third of my income on paying off bills, loans, etc.?

All of these are warning signs that you may have taken on more debt than you can afford.

If you are juggling substantial debt, realize that you are not alone. At the end of 2018, the average overall debt held by U.S. households with any kind of debt was $135,065; the average credit card balance among households with credit card debt was $6,741.¹ For the first three months of 2019, total U.S. household debt rose by close to 1%, according to the Federal Reserve Bank of New York.²

How to Master Your Debt

Understand that while debt may initially seem like an unshrinkable mountain, it can be diminished one piece at a time. Gaining an overall understanding of your finances, including any debt you may hold, is probably the best way to do that.

The first step is to document your income. Look at your paychecks and assess how much money is coming in after taxes on both a monthly and an annual basis. Do the same for any other sources of income you may have.

The second step is to document your expenses. Ask yourself:

- How much do I spend monthly on necessary items such as rent, food, insurance, gas, and electricity?
- How much do I spend on optional items such as going to the movies, eating meals at restaurants, and buying expensive drinks at the coffee shop?

The third step is to document and understand your debt. For each loan and credit card, find out:

- What is the amount I owe?
- What is the interest rate?
- What is the payment schedule?

Use the information you’ve gathered to determine how much money you can dedicate to paying off your debt, as well as to project a timetable for doing so. From time to time, review your expenses to see if there are any new ways to allocate extra funds to reducing your debt. Also consider using cash instead of credit, as well as temporarily taking on some additional (perhaps seasonal) work, to help reduce your debt.

To tackle existing credit card debt, consider strategies such as paying off the card with the highest interest rate first, transferring your balance to a card with a lower interest rate, and paying more than the minimum amount. The last strategy is very important, since the less you pay off, the greater the interest will be and the longer it will take to pay off your balance in the long run.
It’s Worth the Effort

Having too much debt can leave you cash strapped and unable to handle a financial emergency or make progress on saving for retirement and other financial goals. In fact, close to 40% of households surveyed by the Federal Reserve Board in 2018 said they would not be able to cover an unexpected expense of $400 using cash, savings, or a credit card paid off at the next statement. Outstanding credit card debt likely contributes to this dilemma, since many households that actually have at least $400 in their bank accounts would not have that much after accounting for what they owe on their credit cards.

You can avoid such pitfalls by analyzing your spending, controlling expenses, and establishing a plan to reduce -- and perhaps eliminate -- your debt. A financial professional can help you with your planning.

Source/Disclaimer:


4Anqi Chen, “Why Are So Many Households Unable to Cover a $400 Unexpected Expense?,” Boston College Center for Retirement Research, July 2019.