

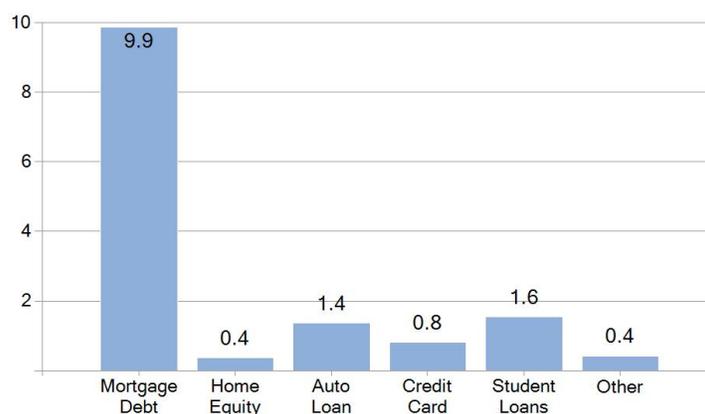
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# Debt Repayment Strategies

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For better or worse, personal debt is a fact of modern American life. And, as a nation, we do take on a lot of personal debt. According to research by the Federal Reserve Bank of New York, at the end of the 3<sup>rd</sup> quarter, 2020, Americans owed roughly \$14.35 trillion.<sup>1</sup>

## Consumer Debt, in Trillions



Not all debt is bad, of course. Debt which helps build for the future, such as student loans, home mortgages, and business development loans, is often seen as “good” debt. But too much debt, even if it’s good debt, can be overwhelming. Debt can be expensive, stressful, and a financial drag on achieving other life goals.

## Getting Organized

The first step in paying off debt involves getting organized:

- **What do you owe?** – List the dollar amount of each of debt, the interest rate, and the minimum monthly payment. You may find it useful to rank order your debts, either in order of their size or the interest rate you’re paying.
- **Cash flow** – Do you have a clear idea of how much money is coming in each month, how much is going out, and where it’s going? If not, a cash flow study is in order.

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<sup>1</sup> Source: Federal Reserve Bank of New York, Quarterly Report on Household Debt and Credit, 3rd Quarter, 2020, November, 2020. Values shown on chart are in trillions of dollars.

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- **Budget** – Once you understand your cash flow situation, develop a budget. A budget is simply a plan for using the money you do have, to allow you to reach the goals you want to achieve. Be sure to budget at least the minimum payment for each debt. You should also look for ways to reduce unnecessary spending or bring in additional cash.
- **Avoid taking on additional debt** – You’re already in a hole. You don’t want to keep digging, to make the hole deeper.
- **Credit report** – Check your credit report regularly. Incorrect information could result in your being charged a higher rate of interest for a loan, or even being denied a loan.

### Debt Repayment Strategies

The next step is to select the debt repayment strategy that works for you.

- **Highest interest rate first** – Since interest is the cost of renting money, it makes mathematical sense to focus on high-rate debt first. Assume you have three debts: Debt A at 12.5%, Debt B at 10.0%, and Debt C at 6.0%. With this strategy, start by paying off Debt A first. Once Debt A is eliminated, use the payment from Debt A and the payment for Debt B, to pay off Debt B. When Debt B is paid off, use the combined payments from Debt A, Debt B, and Debt C to pay off Debt C.

The downside to this strategy is that you may become discouraged before you see any significant progress.

- **Smallest balance first** – Another approach is to start with the smallest balance first. Assume you have three debts: Debt D, of \$1,000 at 10.0% interest; Debt E, of \$2,500 at 12.0% interest; and Debt F, of \$18,500 at 9.0%. Here you would start by first paying off the smallest debt, Debt D. Once Debt D is paid off, then use the payment from Debt D and the payment for Debt E, to pay off Debt E. Once Debt E is paid off, use the combined payments from Debt D, Debt E, and Debt F to pay off Debt F. This approach generally allows you to see progress fairly quickly and can keep you from being discouraged.
- **Minimum payment on all debts** – Make just the minimum payment each month on each debt. Perhaps the longest road to completely paying off all debts.

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- **Debt consolidation** – In some situations, it may make sense for a borrower to take out a single large loan and use the proceeds to pay off a number of smaller loans. This can make it easier to manage the repayment process, but often results in a longer period of time needed to repay the large loan, a higher interest rate, or both.
- **Other ideas** – Some individuals may prefer to pay off certain types of debt first, for example paying off credit cards before paying off other types of debt. Setting up automatic payments can make the repayment process much less painful. Leaving room in your budget for at least a small emergency fund can avoid having to take on more higher-interest debt when an emergency does occur. If conditions allow, you may be able to refinance certain debts at a lower interest rate.

The key is to select the strategy or approach that works for you.

### Get Help If You Need It

The advice and guidance of a financial professional can be useful in sorting out the various options for repaying debt.

### Other Resources

The federal government makes a number of resources available to the public:

- **Consumer Finance Protection Bureau:** On the internet at <https://consumerfinance.gov/>
- **The Federal Trade Commission** has a number of free publications available at: <https://www.consumer.ftc.gov/topics/money-credit>
- **Federal government publications:** A number of useful consumer publications are available from the federal government at: <https://pueblo.gpo.gov/Publications/PuebloPubs.php>