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How Did I Get Myself Into Debt and How Can I Get Myself Out?

Introduction:

Americans have always had a strange obsession with debt. It seems like we seize every chance we get to finance something. Gone are the days of only financing a house or a car. Now, in addition to making purchases on a credit card, we can finance almost anything rather than pay upfront. This often results in either a loan or new credit card being opened, sometimes without the borrower's full understanding. Today I can finance furniture, appliances, medical procedures, and even my professional liability insurance (yes, finance, not just pay interest-free in installments). I can finance that (fictional) cosmetic procedure I always wanted and pay it back with interest over a period of time. Why save up for the cosmetic procedure when I can just spend money I do not (yet) have and make it a burden for future me? Most doctors and hospitals will work with patients on payment plans that are interest free-at least for essential services. Buy now, pay later is all the rage - especially with online shopping.

We also can't get enough of our credit cards. More stores than ever offer credit cards. In fact Walgreens justl began offering a credit card in the second half of 2021. Credit cards are popular for the convenience they offer. Few consumers carry cash and no one is running to an ATM on the way to purchase a laptop. Store credit cards are attractive as stores typically offer a generous discount on your first purchase and rewards on future purchases, enticing you to open a new card at that store. Rewards programs are another reason people open up new credit cards. More and more people are traveling and shopping on points, so opening a new card for 75,000 reward points (or more) is a big draw. Debit cards are not going away, but until they offer the rewards to match credit cards, people will mainly choose credit cards because they are getting something in return.

> *Confession: I opened up two credit cards several years ago and used the reward points from the introductory offer to cover flight and hotel for a destination wedding.*

Lenders and merchants make all of these options so attractive, and encourage poor spending habits. An overwhelming majority of Americans have credit cards. A recent study conducted by the Federal Reserve Bank of Atlanta showed that 79% of American consumers have a credit card. This would not be a bad thing if we were not so easily influenced by promotions and payment plans, but we are losing focus on present dollars and cents. Paying later, or over a monthly or yearly term, will typically carry interest. Most of us don't like math and we are certainly not walking around with financial calculators when we make purchases. The interest rate on credit card purchases, if you do not pay your balance in full every month, starts at around 9.99% and has no limit. This is how banks make money off credit card consumers.

If you're reading this, you probably fall into one of two categories. Either you're facing significant debt or you're interested in learning how to avoid the debt traps. I hope this resource provides good tips and advice to help you eliminate your debt or avoid incurring debt.

The bottom line is that life happens. How you deal with debt is paramount so it does not consume you and create unnecessary stress (or cause health issues created by that stress). It is important to get ahead of the debt before the debt gets ahead of you. This resource will hopefully change your mindset, guide you through managing debts, and help you overcome one of life's great stressors. It will address the following:

- How you get caught up with bad debt and the traps to avoid
- Traditional repayment options
- Non-traditional repayment options and theories to eliminate debt (alternatives to bankruptcy)
- Options when you are unable to keep with payments, including bankruptcy

So how did I get myself into debt?

For the purposes of this discussion let's assume that we're all honest and good-natured people and not the type to accrue debt with no intentions of paying it back. Having said that, I can answer this question in two words: life happens.

We are conditioned to believe that we will be better off in the future. That's the optimist in all of us. Often that means that we are more likely to pay less now with the expectation that we will be able to make payments with interest down the road. Now don't get me wrong, there's nothing wrong with being optimistic. We just need to be wiser when it comes to our money and keep an eye on the prize. What's the prize? In short, it's financial security. This means something different for everyone but may include some or all of the following: significant savings as a reserve, a down payment for a house or apartment, being debt free, and retirement savings.

Despite even our best planning, sometimes things don't work out as we expect. People get sick or injured and can't work. They may receive reduced compensation or none at all while staring at a pile of medical bills. People lose their jobs due to budget cutbacks, a slow economy, or, more recently, a pandemic. You may graduate from high school or college and find that job prospects are not what you anticipated. All of this results in having less income than expected. Even if you were able to cover all monthly expenses before an unplanned event, a reduced or lost source of income can jeopardize that. Now throw in the additional expenses that you thought you would be able to pay down the road, and your expenses become greater than your income.

Divorce is another big cause of debt. Getting divorced can be very expensive and an ongoing support order will consume a sizable chunk of income. Legal fees for a divorce can add up quickly. In addition, after a divorce one spouse may be solely responsible for a debt that the former spouses shared. The stress of the divorce process often leads people to spend more as a coping mechanism, to try to feel better. Finally, after a divorce some celebrate their newfound freedom with a splurge. It may be a shopping spree or a nice vacation, but it can get costly.

When your expenses are greater than your income you have two choices. First, you may dip into reserves to cover the difference. For some, that may only work for a short period of time while others may have deeper reserves to cover their expenses. A second option is to accrue debt. You may borrow from friends or family, take out a loan, or rely heavily on credit cards until things return to normal. Credit cards and personal loans are the most common approach.

The next part is mindset. Take a small child who has no understanding of money. If I offer a small child a choice of either three nickels or one quarter, that child will always take the nickels because three is more than one. If you're reading this, you know that a quarter is worth more than three nickels and would never fall for that. As adults we get tricked in other ways, helping banks make money and burying consumers in debt. Banks offering loans and credit cards do so as a service to us, as part of a business model. They make money off of interest, penalty interest rates, and any other fees they can charge.

We often believe, irrationally, that having lower monthly payments is always better, regardless of the terms. Making smaller payments over time sounds more attractive than one large payment immediately. If you owe $5,000 on a credit card you can either pay it in full or make a lower payment. The statement may say that you can make a minimum payment of only $125. What a deal! Until you read the fine print that says that if you make that minimum payment every month it will take <u>five years</u> to pay off the balance and you will pay over $2,100 in interest. You may not have $5,000 today to pay it off, but simply making minimum payments to pay it will be costly.

Now suppose you're looking for a new refrigerator because yours broke and it is too costly to repair. You can pay for the refrigerator up front, but it's likely that the salesperson will offer you some less favorable financing terms. We're seeing this more and more with online shopping in the form of "buy now, pay later." Rather than paying for an appliance immediately, we are again tricked into believing that making small monthly payments is better. Here's what that means:

> *I purchase an appliance for $1,000. If I choose to finance it at an interest rate of 8%, the cost over 24 months is $1,085. Over 60 months the cost is $1,217. Paying it off over 60 months essentially carries a 20% premium.*

Interest can be your best friend or your worst enemy. When planning for retirement, compound interest is the greatest. The money you contribute at 25 years old continues to earn interest. That interest is then added to the principal (original contribution). With interest continuing to accrue on the principal and prior interest earned, your retirement savings grows exponentially. However, when it comes to unpaid balances, interest is the enemy. It costs us a great deal of money.

> *Disturbing Fact: First Premier Bank once offered a credit card with a 79.9% interest rate. As of this writing, they offer a card with an interest rate of 36%. Both cards were available to consumers with bad credit.*

We don't always think about interest or the term of a loan when factoring in total cost. Here are two eye-opening examples that we commonly face in our daily lives:

1. If I take out a $300,000 mortgage at 3.5% over 30 years, the total cost of the loan is $484,968.

2. If I finance a $35,000 vehicle and put $5,000 down, that $30,000 at 3% over six years will cost $32,818.34. If you have poor credit, your interest rate may be 9% (or more!). At 9% the total cost is $38,935.16. Having poor credit will cost you an additional $6,000 in interest.

According to Experian, the average term for financing a new vehicle is now just over 71 months, or nearly six years. However, seven-year loans are becoming increasingly popular. In the example above you would be paying $3,297.52 in interest with good credit, or $10,544.48 in interest with bad credit over seven years. Be smart and purchase wisely. Pay what you can afford now. Don't stretch out your payments just to get a lower monthly payment and create a lengthy obligation for “future you”. Future you will already have his or her hands full. Train yourself to think more rationally, rather than emotionally, when it comes to spending.

Interest is not the only cause here. Credit cards can be problematic because they provide us with the freedom of being able to purchase anything, anytime, with a spending limit that can often cover the cost of an inexpensive new car. Credit cards offer the convenience of being able to make a purchase when we may not have the funds available to immediately pay for it. If we had the funds available, we could pay with a debit card and not incur debt. Credit cards are great when used wisely and safely – otherwise they can be dangerous. This is another way to get caught up in debt.

Common sense says that we shouldn't buy something if we can't afford it. When emotion gets the best of us, we tend to make purchases beyond our means. This does not apply to emergencies. If my boiler breaks in the middle of the winter and I don't have the cash to pay for the repair, of course I'm going to repair or replace it. That expense will have to go on a credit card. That new suit, shoes, or purse in the store window is probably not an emergency. If you walk into the store they may even offer you 15% off if you open a new store credit card, making that purchase even more enticing. Don’t fall into that trap!

Credit card debt can start at a young age. I remember back when I first started college there were tables set up at orientation with credit card representatives trying to get students to open up new credit cards. They likely gave out free t-shirts or college swag to new applicants. When you are eighteen years old and facing this newfound freedom of being away in college (or even if you stay local), one of the first ways to declare your independence is to open a new credit card. No one is taking the time to explain to teenagers how repayment, interest, and fees work. If you get stuck with significant debt at a young age, it can weigh you down for years to come. The years immediately after college are best for accumulating savings, not paying off credit card debt.

We all have our fixed monthly obligations like rent or mortgage, vehicle payments, and insurance (health, life, vehicle, etc.). Those tend to stay the same every month. Mortgage and vehicle payments are typically good debts that lead to good assets when paid off. We also need to eat, travel, and take care of our children and/or pets. These expenses vary month-to-month. Add in other debt payments like student loans and credit card payments and if you don’t have solid financial footing with sufficient income and reserves, you can easily find yourself out of cash and unable to pay for your monthly expenses. That takes you back to credit card reliance, beginning the debt cycle.

DEBT STATISTICS

1. Americans owed approximately $787 billion in credit card debt.[1]
2. In the first quarter of 2021, approximately 54% of active credit cards carried a balance.[2]
3. In a recent study by LendingTree, the average credit cardholder in New York owes approximately $6,973 (9th most in the country).[3]
4. Student loan debt in the United States totaled $1.54 trillion in the second quarter of 2021.[4]
5. A recent study reported that Americans owe an estimated $140 billion in medical debt.[5]
6. Approximately half of Americans are carrying medical debt[6] with an average balance of $2,424 in 2020.[7]
7. The median monthly mortgage payment according to U.S. Census data is approximately $1,609[8]; it's approximately $2.114 in New York.[9]
8. From April 1, 2020 through March 31, 2021, there were 453,438 consumer bankruptcy cases filed, down from 741,168 for the prior twelve month period (pre-pandemic).[10]

I am not pointing this out to paint a picture of doom and gloom – in fact, quite the opposite. Being in debt is perfectly normal as long as you have the right tools to manage it. We are all too focused on credit scores, and the easiest way to establish credit is to create and pay off debt. Owning and using a credit card is not wrong (or evil). A good credit card can offer certain protections and benefits, including a good rewards program. The average homeowner who is current on his or her mortgage payments may be in debt hundreds of thousands of dollars but is living the American dream. He or she is paying a mortgage and will eventually own his home free and clear of that mortgage or sell down the road and hopefully walk away with a large sum of money at closing.

Like everything in life, it's important to consume in moderation. Understand what you have and what you need to make ends meet. Once you've accomplished that, you can then shift to luxuries. If you are easily making ends meet and are relatively debt-free, congratulations as you are likely in good shape. Whether you earn an excellent income or are struggling to get by, you can still find yourself facing significant debt. We have this mindset that carrying debt is good but that needs to change. Sometimes it's inevitable, but it should not be a goal or mark of accomplishment unless you can afford the payments. The reward when debt is paid off is a tremendous feeling of accomplishment. In addition, if you just paid off a car or a house, you now possess a valuable asset.

So how can I get myself out from under this debt?

Facing significant debt is not the end of the world. You have to be willing to adjust your spending habits and your mindset to successfully carry out a plan to resolve that debt. As I mentioned earlier, we do not always think rationally or logically when it comes to how we pay for consumer goods. We're all guilty of it. Emotion takes over and that can lead to repeating the same bad habits that got you into this situation in the first place. Purchasing a pair of shoes that you really want and can't afford or that you don't really need but you think look amazing is purely emotional. Falling for the promise of low monthly payments when the interest will cause you to pay significantly more for a purchase is irrational. I highlighted many of the tricks and traps that cause people to incur debt, now we're going to discuss how to get out from under your debt.

BUDGET, BUDGET, BUDGET

Before we get into repayment options and tips, it is important to evaluate your resources to determine your ability to make payments on a monthly basis or use your reserves (personal savings, <u>never</u> retirement savings) to pay off your debt. I will go through this process step-by-step. This system will help those on a fixed income, regular salary, independent contractors, and business owners.

If you are facing significant credit card debt and looking to get out from under it, you must first commit to ending credit card use. It will take that much longer to pay off debt if you are making payments while also adding to the debt. Plus, by paying with cash or a debit card you can easily see how much you spend in a given category.

Step 1: Review your income
Believe it or not, many people do not know how much they take home on a monthly basis. Unless you receive a fixed income, it's not always clear. You may know your gross annual salary, but can only estimate your net income. For instance, if you get paid weekly, or bi-weekly, you cannot simply take your net and multiply by four (or two, if paid bi-weekly), to determine your monthly net income. Why not? You're selling yourself short. Most months have 30 or 31 days, so your income is not based on four weeks (28 days) of work. If you get paid weekly, you should multiply your net income by 4.3 and if you get paid bi-weekly, multiply your net income by 2.15. This takes into account those months where you get an "extra" paycheck because there are three or five Fridays (typically twice a year).

Make sure to include income from all sources including any rental income, side businesses, and spousal income. All of this income ultimately goes towards the household expenses and will give you a true picture of the household income to then compare with your household expenses. Do not rely on bonuses or tax refunds when reviewing your monthly income.

Determining income if you are self-employed, an independent contractor, or own a business can get tricky. You may have your gross receipts, but you likely incur business expenses to derive that income. All of that must be factored in to determine your net income. This is where a profit and loss statement comes into play. You can contact your accountant or bookkeeper for assistance, but I prepared a simplified form for you (see Appendix). Now review your records for all business expenses. I suggest looking at income and expenses over a six month period to provide a reasonable sample size. Don't forget to set aside funds for taxes, whether you make quarterly or annual payments.

For the purpose of this exercise, do not include any business expenses that may also be personal expenses as you will document personal expenses in Step 2 below. While the IRS may allow certain expenses and deductions, this is not a tax return and filling this out like a tax return will not give you an accurate financial picture. For instance, if you use your cell phone for business and personal use you should consider that a personal expense here. In addition, do not include any salary or distribution that you may take from the business as the net profit is all yours. Of course, if you are only a part owner, note your share of the net profit only. Once you complete this form, average out the gross profit and expenses to determine your average net profit or loss.

Step 2: Assess your monthly spending
Next you need to take note of your monthly living expenses. This will require more attention to past spending habits, including a review of what you may typically charge on a credit card. It will help to look back at receipts, bank statements, and credit card statements over the past several months. The household expenses should include any payments that are coming due or known to increase in the near future.

I prepared an expense worksheet to use as a guide to help you break down typical monthly expenses (see Appendix). Make sure you factor in all household expenses. You can't starve your kids to pay off your debt. Use this worksheet to break down all monthly household expenses and find the total. Include student loan payments, because there are only so many repayment options there. Do not include credit card payments as you are trying to determine how much you have available to go towards those debt payments.

You may be shocked when you see where your money has been going each month. It's possible that you may be able to trim some of those expenses, but be realistic. If you make your budget too tight, it may not be manageable and you will not succeed. It must be sustainable. Trimming 15% of your expenses doesn't do you any good if you can't stick to that. The goal of this exercise is to determine how much you can put towards creditor payments to evaluate the best way to address this debt. You may also identify some unnecessary spending to trim your expenses.

Step 3: Review discretionary income

Discretionary income is any money left over after all necessary expenses are paid. In an ideal world, you would have sufficient income to cover your necessary living expenses, treat yourself to some luxuries, and have additional savings for emergencies and whatever the future holds. That isn't the case for everyone so you have to work with what you have. Now that you have estimated your monthly income and monthly expenses, you can now see how much discretionary income you have.

I am not advocating to use every last penny to pay creditors. It is a highly aggressive tactic that is extremely dangerous and runs counter to every rule about saving. However, by subtracting your monthly household expenses from your monthly household income you can determine how much remains for some combination of saving and paying debt. If you do not have any discretionary income, your options may be more limited but relief can be quicker (potentially explore bankruptcy). If you have discretionary income, you should then determine how much you can comfortably put towards debt payments while still saving enough to cover at least six-months of expenses in case of any unforeseen event or emergency.

Just as it is a good idea to consult with a financial advisor to help guide you in budgeting to save for your future, you should speak with a debt attorney to review all options if you are facing significant debt. In addition to reviewing your budget, that attorney can also go over all options with you to help eliminate this debt. Use that attorney as a guide or coach to help you reach your goals. Most importantly, keep your attorney in the loop and reach out with any questions before you act.

When considering what debt to pay back or in what order, I always suggest prioritizing the most important creditors to you. For instance if you owe mortgage arrears, plan to devote more attention and resources to that, as you need a roof over your head. Back child support or maintenance are up there too as you could face stiff penalties or possible jail time for non-payment. The IRS or other taxing authorities are also important because you never want to mess with Uncle Sam (he charges interest and penalties too!). Beyond those, credit cards, personal loans, and medical debt have a lower priority, despite the high interest rates, as they carry fewer consequences if unpaid (Note: I do not advocate non-payment).

Additional Funds:
In addition to your discretionary income, you may have savings that can go toward paying off debt. Ask any financial advisor and they will always tell you to always set aside at least six months of expenses in case of emergency. While I am not a financial advisor, I strongly agree with this position because anything can happen. You should never go broke just to pay off debt. So unless you have significant savings, you may not be in a position to use your reserves to pay off debt.

However, you may also receive other funds over the course of a year. No, I'm not talking about a wealthy grandparent who sends generous checks for your birthday or around the holidays. In a given year, you may also receive an annual or quarterly bonus. You may also receive a state or federal income tax refund. Those may be worth sacrificing for the goal of becoming debt free.

REPAYMENT OPTIONS AND THEORIES

In an ideal world everyone using credit cards would be able to pay their bills in full each month and not carry balances. That's not realistic when we have a mindset that making minimum payments is good and carrying debt is okay. Sure, having some credit card debt early on may be okay. Unfortunately, as you've read, debt has a way of spiralling out of control really quickly and we have a tendency to ignore how interest can increase that debt. The cost of carrying debt is more than just a ding on your credit score. Here are some of the most common ways to address debt, along with their pros and cons:

1. Minimum Payments

You get a statement in the mail and it says you have a balance of *X* but can make a minimum payment of *Y*. If you're unable to make the payment in full you may elect to pay *Y*. Surely you can pay more than *Y*, but when consumers see that paying *Y* is an option, and a relatively low payment, they stick with the minimum payment. Minimum payments are simply the least a lender will accept without charging a late fee. Interest will continue to accrue on the unpaid balance. If you are carrying significant credit card debt and have a very tight budget, maybe all you can afford is *Y* so that's what you pay. But that's probably the only time making minimum payments makes sense.

As you know, banks make money on interest. If you are paying anything less than the full balance, interest accrues on the remaining balance every month. If you have a $4,000 credit card bill, you're not going to pay it off by making 40 payments of $100. By law, credit card companies are required to disclose how long it will take to pay off a debt if you only make minimum payments. You will see how long it will take and that information will shock you.

<u>Example</u>: In a recent month, I received a credit card bill for $3,289.66. This was a higher bill than usual but is a great example of how minimum payments with compounding interest will cost you much more in the long run. The interest rate on that card is 15.99%, which is typical for credit cards even with excellent credit. Of course if I miss a payment, the penalty interest rate would be around 27%. They were willing to accept a minimum payment of $32.89. Not so fast! If I make minimum payments until the balance is paid off it would take fourteen years(!) and I would pay a total of $6,685. That's more than double the initial balance. Needless to say I paid the balance in full by the due date.

Pros: low, fixed payment
Cons: will take many years to repay, most costly repayment option

2. <u>Snowball Method</u>

The snowball method is one strategy to pay off debt. In this method, you are paying off debt by putting a focus on the account with the smallest balance first. The idea is that you start with the easiest goal and every time you pay off an account you feel accomplished and motivated, and carry that success to the next account.

With the snowball method, you are making minimum payments on all accounts. Any money left over each month is then allocated towards the account with the smallest balance. When that account is paid off, the new money left over (the money used to pay off the first account) then goes to pay the account with the second-lowest balance. This process continues until you pay off the account with the largest balance and eliminate your debt.

While it's easy to see results, this method has one major flaw. The snowball method does not take interest into account. As I've said many times, interest on debt is your worst enemy. If you are paying off the smallest balances first and the accounts with larger balances have a higher interest rate, you are going to pay back a great deal more over the course of repayment. The snowball method does not make sense financially, but sometimes you need assistance getting into good habits. This method allows you to see results quickly and keep you on a path towards repayment.

Pros: higher likelihood of completion, easy to see results
Cons: can take a long time, more costly as it does not factor in interest

3. Avalanche Method

The avalanche method is the opposite of the snowball method. While the snowball method focuses on paying off accounts with the smallest balances first, the avalanche method focuses on paying off the accounts with the highest interest rate first. Once again, you are making minimum payments on all accounts. Using the avalanche method, you are allocating any additional funds towards the accounts with the highest interest rates. This helps minimize the hefty interest that will accrue over the course of your repayment plan.

It is possible that some accounts with the lowest balances have the highest interest rates. Here, the avalanche and snowball methods will align and you can carry that success of paying off one account to paying off the next one. The two methods split if you get to an account with a large balance and high interest rate early on. The avalanche method says to attack that large balance early, while the snowball method defers it. With the avalanche method, it can take a long time to pay off that large balance account. During that time it is easy to regress and get caught up in the same bad habits that got you into debt in the first place. If you can exercise self-control, stay focused, and keep your eyes on the prize, it is possible to successfully pay off your debt using the avalanche method.

Pros: pay less interest over repayment period
Cons: requires more discipline, easy to fall back into bad habits

4. Settlements or repayment plans directly with the creditor

Sometimes you may have access to funds to pay a large chunk of the debt but not the full amount. Maybe you've been saving for some time or friends and family have offered to help. In this case, debt settlement may be a good option for you. Here, you negotiate with creditors to reach a discounted payoff. Typically the best settlements are available when you're able to make a single lump-sum payment.

In my experience, bringing in an attorney to negotiate on your behalf will result in significantly more favorable settlements. When creditors hear from borrowers directly who say they have access to funds to settle, creditors often believe there is an endless amount of funds and are less inclined to offer any real favorable settlement.

Another type of settlement is the creation of a repayment plan directly with each creditor. Creditors may be willing to work with you to pay off the balance by creating a monthly payment plan. This will allow you to pay off a debt over several months. Often they will reduce your interest rate (sometimes to 0% if you're lucky) and occasionally they will even offer a small discount on the balance.

The biggest drawbacks of debt settlement are possible tax consequences and that the best settlement typically requires having funds for a lump-sum payment. As a general rule, debt forgiven is taxable and anything forgiven over $600 could result in the creditor issuing a 1099-C tax form. If you can demonstrate insolvency, you may be able to avoid paying tax on that cancellation of debt (consult your accountant). Another major drawback is that many people don't have access to funds for a lump sum. As for lengthy repayment plans, staying with them is always a challenge. Once you breach, you are opening yourself up to collections, lawsuits, and judgments.

Pros: often cheapest overall (excluding bankruptcy), easier to re-establish credit
Cons: no protection from lawsuits until settlement is made, possible tax consequences, best settlements require lump-sum payment

<u>Caution</u>: Be careful about liquidating retirement accounts to pay for settlements. There may be additional tax consequences for early withdrawals, plus you will need those funds (and the compounding interest) when you retire.

<u>A few words about debt settlement companies</u>:
Be careful about third-party debt consolidation or settlement companies. These companies will typically start a payment plan with a debtor before any agreement is made with a creditor, so there's no guarantee that the payment is enough to cover all the settlements. Many will try to work out settlements for you but you have no protection from creditors until a settlement is made. During that time you may be opening yourself up to lawsuits. If you or your attorney are working directly with the creditor, you know exactly what's going on and can typically hold off lawsuits.

5. Debt Consolidation Loan

A debt consolidation loan is a loan taken out to pay off multiple other accounts. Those other balances are consolidated into this one new loan and those other accounts are now paid. The biggest advantage here is that rather than keeping track of multiple accounts with their own due dates, you only need to make one payment on this new loan. However, this is a loan and carries its own repayment terms and interest. If you are unable to make this loan payment, consolidating your debt really hasn't helped you.

> *Pros:* you can go from multiple accounts with balances to one, easier to keep track of one payment
> *Cons:* you are still carrying debt that is accruing interest

BANKRUPTCY

Of course when there are no good repayment options available or the idea of paying back debt for fifteen years while struggling doesn't make much sense, bankruptcy is another option to eliminate debt. Bankruptcy may also be a first option to quickly put an end to the struggle, especially when there are no funds available for repayment or there are funds available and you are looking to save a home from foreclosure. There are two common types of consumer bankruptcy, each with its own advantages and disadvantages.

Once a bankruptcy petition is filed, you are immediately protected from your creditors, stopping lawsuits, wage garnishments, and foreclosure sales. The Bankruptcy Code also offers some cool tricks such as reducing the balance owed on a car loan, voiding a judgment lien on real property, or stripping off a second or third mortgage. These benefits can be huge if your case has the right set of facts to allow for these types of relief.

A Chapter 7 bankruptcy is a quick option to eliminate debt. It takes about three months from the time a petition for bankruptcy relief is filed with the court until a discharge order is issued eliminating debt. There are certain income requirements to qualify for Chapter 7 including a "means test" and budget analysis. Not all debt is eliminated in a Chapter 7 case as child support, alimony, maintenance, debts incurred by fraud, some taxes, and most student loans are not dischargeable in bankruptcy.

It is important to note that not all assets are protected in bankruptcy so you must look to either state or federal law, depending on where you live, to determine what assets are exempt (protected) from the bankruptcy estate. Most Chapter 7 filings are "no asset cases" in that no payments are made and no assets are turned over to a trustee for the benefit of creditors.

> *Chapter 7 Pros:* quickest solution; will eliminate almost all debt, major protections under federal law, unique remedies available within a bankruptcy case
> *Chapter 7 Cons:* income requirements to qualify, not all assets can be protected

Chapter 13 cases differ from Chapter 7 cases. In a Chapter 13 case, you are creating a payment plan to repay your debt over a period of 36 to 60 months. Chapter 13 is typically utilized by those looking to save a house from foreclosure by creating a repayment plan to cure mortgage arrears or if your income is too high to qualify for Chapter 7.

When it comes to general unsecured debt (credit cards, personal loans, medical bills, etc.) you can pay those back at pennies on the dollar if that is all you can afford. The monthly payment is based on disposable income and you will have to pledge all your disposable income to fund the repayment plan. If your disposable income is more than enough to pay all your debts in full over a 60-month plan, you must pledge enough to pay those creditors in full.

A Chapter 13 case requires a three to five year commitment. It therefore requires a good amount of discipline and proper budgeting to stay on top of your regular monthly obligations along with this repayment plan. However, the reward is great as you are making one payment every month to eliminate your debt.

> *Chapter 13 Pros:* payment plan based on disposable income, cost effective, protected from creditors, unique remedies available within a bankruptcy case, can get creative in structuring repayment plan
> *Chapter 13 Cons:* payment plan up to 60 months, requires discipline, if pledging all disposable income there may not be room for savings

Conclusion:

There are many ways to eliminate your debt. The key is to identify which plan works for you and stick to it. Think about how you got into debt and make the right adjustments so you can get out of it. It may be as simple as changing your mindset or being aware of how you spend your money. You should also contact an attorney who focuses on debt to guide you through your options, keep you focused so you stay on track, protect you from overaggressive creditors, and look out for your best interests. Think of that attorney as a coach, support team, and advocate. Zimmelman Law PLLC is here to help New Yorkers eliminate their debt with dignity.

Sources for Debt Statistics

1. Federal Reserve Bank of New York – https://www.newyorkfed.org/microeconomics/hhdc
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5. Standford Institute for Economic Policy Research – https://siepr.stanford.edu/news/americas-medical-debt-much-worse-we-think
6. Forbes – https://www.forbes.com/sites/debgordon/2021/10/13/50-of-americans-now-carry-medical-debt-a-new-chronic-condition-for-millions/?sh=421cabd85e5d
7. Standford Institute for Economic Policy Research – https://siepr.stanford.edu/news/americas-medical-debt-much-worse-we-think
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9. Insider Inc. – https://www.businessinsider.com/personal-finance/average-mortgage-payment
10. Administrative Office of the U.S. Courts – https://www.uscourts.gov/statistics/table/f-2/bankruptcy-filings/2021/03/31

APPENDIX

Here are the sample forms to help you make a budget. Many financial advisors will stress budgeting and a regular review of your household budget so you can stay organized and pay bills on time. These forms will help you get a better idea of where your money is going each month. They will also help us get a clear understanding of your finances and help us determine the best solution for your financial hardship.

Expense Worksheet: Use this form to break down your monthly household expenses by category. Take some time to make sure everything is listed. You may need to review bank statements and credit card statements over the past few months. Then, subtract your total expenses from your monthly income. This will tell you how much discretionary income you have to go towards your outstanding bills and savings.

Sample Profit and Loss Statement: This form is for business owners, independent contractors, and those who are self-employed to determine your net income. Use the past six full months as a guide and enter your income and business expenses (no personal expenses, as they go on the Expense Worksheet above). You do not need any accounting experience – we've simplified this form for you. For many small businesses, especially sole proprietors, the net income of your business is your personal income. If you take a separate salary please be sure to note that as an expense on the form separate from all other salaries.

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EXPENSE WORKSHEET

Name: ____ Date: ____________________

List expenses for your entire household on a monthly basis:

1. Rent/Mortgage: $___________ Second Mortgage: $___________
   a. Property taxes *(if not in mortgage)*: $___________
   b. Homeowner's insurance *(if not in mortgage)*: $___________
   c. Condo, co-op, or homeowners association dues: $___________
   d. Renter's insurance: $___________
2. Home maintenance, repairs, and upkeep: $___________
3. Electricity, heat, and gas: $___________
4. Water, sewer, and garbage collection: $___________
5. Cable/internet/phone package: $___________
6. Cell phone(s): $___________
7. Food and housekeeping: $___________
8. Childcare, babysitting, and children's education costs: $___________
9. Clothing: $___________
10. Laundry and dry cleaning: $___________
11. Personal care: $___________
12. Medical and dental expenses: $___________
13. Transportation (gas, tolls, maintenance, and public transportation): $___________
14. Entertainment, recreation, newspapers, and magazines, and books: $___________
15. Charitable contributions: $___________
16. Insurance (*do not include payroll deductions)*:
    a. Life: $___________ c. Vehicle: $___________
    b. Health: $___________ d. Other: $___________
17. Tax payment plans: $___________
18. Car payment for vehicle 1: $___________
19. Car payment for vehicle 2: $___________
20. Student loan payment: $___________
21. Other installment payments: $___________
22. Child support/alimony/maintenance *(do not include payroll deductions)*: $___________
23. Payments to support family not living with you: $___________
24. Other expense: $___________ (specify ____________________________)
25. Other expense: $___________ (specify ____________________________)

TOTAL MONTHLY EXPENSES: $0___________________

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Six-Month Profit and Loss Statement

	______________ 20___ (last month)		______________ 20___ (2 months ago)		______________ 20___ (3 months ago)	
INCOME						
Sales/Services						
Cost of Goods Sold	-		-		-	
GROSS PROFIT		$		$		$
EXPENSES						
Accounting						
Professional Services						
Advertising						
Automobile/Truck						
Vehicle Repairs/Maintenance						
Business Travel						
Business Insurance						
Office Rent						
Office Supplies						
Office Equipment						
Office Utilities						
Postage						
Subscriptions						
Education/Training						
Taxes						
Salaries						
Bank Fees						
Other (explain):						
Other (explain):						
Other (explain):						
TOTAL EXPENSES		$ 0		$ 0		$ 0
PROFIT/LOSS (Gross Profit – Total Expenses)		$		$		$

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Six-Month Profit and Loss Statement

	______________ 20___ (4 months ago)		______________ 20___ (5 months ago)		______________ 20___ (6 months ago)	
INCOME						
Sales/Services						
Cost of Goods Sold	-		-		-	
GROSS PROFIT		$		$		$
EXPENSES						
Accounting						
Professional Services						
Advertising						
Automobile/Truck						
Vehicle Repairs/Maintenance						
Business Travel						
Business Insurance						
Office Rent						
Office Supplies						
Office Equipment						
Office Utilities						
Postage						
Subscriptions						
Education/Training						
Taxes						
Salaries						
Bank Fees						
Other (explain):						
Other (explain):						
Other (explain):						
TOTAL EXPENSES		$ 0		$ 0		$ 0
PROFIT/LOSS (Gross Profit – Total Expenses)		$		$		$