How to Take Control of Your Debt

Debt's not necessarily a bad thing—unless it's out of control. Follow these methods to regain your financial power.

by NEA Member Benefits

Kim and Hasan recently attended a financial planning seminar at work. When the advisor asked the audience members to share their feelings about debt and spending, Kim was brimming with confidence as she answered. "I don't have any debt because I pay cash for everything. I don't like to stress about money."

But then Hasan spoke up. "I've got student loan payments that take a pretty good chunk of my income each month, but it's manageable. I use a mileage credit card for most purchases because I like to visit my parents regularly, but I always pay my credit card in full each month. I don't feel like this debt is holding me back."

The advisor assured both Kim and Hasan that they are both handling money in a responsible manner that suits them. "We all have different priorities when it comes to money. As long as you're in control of your finances, you can choose to use some debt as a way to further your goals, or avoid it altogether."

Some debts are "good" and some aren't

If you borrow money to buy something that may grow in value over time, like a home or a college education, it could be viewed as good debt. Also, if you absolutely need something but don't have the cash, like making critical repairs to your home, borrowing money may be a good investment.

Problems arise when you pile up debt by purchasing items you don't need or can't afford. This kind of debt can become a burden every month and may prevent you from reaching your financial goals. Credit cards are the major culprit here. A 2017 NerdWallet study found that the total owed by the average U.S. household that carries credit card debt is $15,432. A significant number of people blamed their credit card debt on unnecessary spending. That means they can fix the problem with a little spending discipline.

Some debts come out of nowhere

You can pretty much count on facing unexpected major expenses, like major home repairs, or a big financial setback, like a job loss, at some point in your life. Though no fault of your own, these events may force you to overuse credit cards just to pay the bills.

Avoid debt by sticking to a budget

The key to managing debt and using your purchasing power to your advantage is to create a spending plan, or household budget, and be disciplined in sticking to your plan. A budget will illustrate your spending patterns and send up a red flag if you're spending more than you're bringing in.

If you find your budget is full of red flags, here are a few suggestions to get them under control:

- **Prioritize big to small.** List your debts and pay off the highest interest rate debt first. When that one is zeroed out, take the same dollars and pay the next debt on the list, until you've cleared the debt decks.
- **Prioritize small to big.** Financial guru Dave Ramsey suggests a counter approach called the snowball method. Pay off the smallest debt first for some positive reinforcement, then apply those payments plus any extra cash to the next biggest debt. Then repeat with the next biggest debt on the list. This allows you to snowball available cash for payments as you work your way up to your largest debt.
- **Reign in your spending.** Stick to spending only on the essentials until you get debt under control. You don't want to run up new obligations while trying to pay off the old ones.
- **Negotiate with creditors.** Call creditors and ask for lower interest rates or if they will take less than the full balance in exchange for a quicker cash payment.

Make credit cards a convenience, not a curse

Credit cards can be a blessing or a curse. Their blessings include convenience, protection against fraudulent use and a line item record of all purchases on your monthly statements. But that convenience may become a curse because it's so easy to buy things you don't really need. If you carry a balance, card interest rates can often be quite high and if you constantly charge up to your credit limit, your FICO® credit score will take a hit.

To keep your credit cards in the blessing category, be sure to:

- **Pay your balance in full, on time, every month.** This avoids those sky-high interest payments that only come into play if you roll over a balance.
- **Be aware of statement closing dates.** If you charge the day before your statement closing date, you'll have to pay that charge within 20-25 days. If you charge the day after your closing date, you won't have to pay for as long as 55 days. That's an interest-free short-term loan (if you pay in full before the due date).
- **Charge regularly but not up to the limit.** Regular use of credit cards will help your FICO score. But that's assuming you pay your balance on time and you keep your card balances to about 10% of the card's credit limit.
- **Reap your rewards.** Cards that offer rewards can be a good deal. Remember to cash in your rewards and periodically calculate if the rewards are more than making up for any annual fees.

When you manage debt responsibly, it can be a powerful financial tool to help raise your standard of living and realize dreams such as owning a home and sending the kids to college. If you stay within your spending plan and be credit card smart, you can make "good" debt a valuable part of your financial plan.

Learn more about financial topics for educators and find helpful tips about budgeting, credit, managing debt and other financial topics at neamb.com/personal-finance.