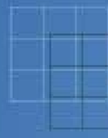

JACQUES F. LIWANPO
CHARTERED ACCOUNTANT
CERTIFIED FINANCIAL PLANNER

Choose with confidence, get the CA and CFP advantage

Yes, You CAN Get Out of Debt!

In America today, carrying some debt is unavoidable, and even desirable, for most households. But between mortgages, car payments, and credit cards, many Americans find themselves over their heads -- unable to dig out from under a growing debt burden that consumes an ever growing portion of their resources.

The average U.S. household now has credit card debt of more than $9,300. Credit card companies have made running up that balance deceptively convenient. What's lost when you're on that spending spree is the realization that paying off your debt can be costly, in terms of both cash on hand and your overall financial health.

Assessing Your Debt

How much debt is too much? The figure varies from person to person, but in general, if more than 20% of your take-home pay goes to finance nonhousing debt or if your rent or mortgage payments exceed 30% of your monthly take-home pay, you may be overextended.

Other signs of overextension include not knowing how much you owe, constantly paying the minimum balance due on credit cards (or worse, being unable to make the minimum payments), and borrowing from one lender to pay another.

If you find that you're overextended, don't panic. There are a number of steps you can follow to eliminate that debt and get yourself back on track. Working your way out of debt will, of course, require you to adjust your spending habits and perhaps be more judicious in your spending.

Begin With a Budget

The first step in eliminating debt is to figure out where your money goes. This will enable you to see where your debt is coming from and, perhaps, help you to free up some cash to put toward debt.

Track your expenses for one month by writing down what you spend. You might consider keeping your ATM withdrawal slip and writing each expense on it until the money is gone. Hang on to receipts from credit card transactions and add them to the total.

At the end of the month, total up your expenses and break them down into two categories: Essential, including fixed expenses such as mortgage/rent, food, and utilities, and nonessential, including entertainment and meals out. Analyze your expenses to see where your spending can be reduced. Perhaps you can cut back on food expenses by bringing lunch to work instead of eating out each day. You might be able to reduce transportation costs by taking public transportation instead of parking your car at a pricey downtown garage. Even utility costs can be reduced by turning lights off, making fewer long-distance calls, or turning the thermostat down a few degrees in winter.

The goal is to reduce current spending so that you won't need to add to your debt and to free up as much cash as possible to cut down existing debt.

Three Steps to Reduce Debt

Once you've got your budget settled, you can begin to attack your existing debt with the following steps:

Pay off high-rate debt first. The higher your interest rate, the more you wind up paying. Begin with your highest-rate credit cards and eliminate the balance as aggressively as possible. For example, assume you have two separate $2,000 balances, one charging 20% interest, the other 8%, on which you can pay a total of 6% per month. If you were to pay 4% per month on the higher-rate card and 2% on the lower-rate card

The Shops on Steeles & 404, 2900 Steeles Avenue E., Suite 207, Thornhill, Ontario. L3T 4X1

Phone: 905.881-6257 . Fax: 416.352.1501 . Email: jacques@liwanpo.com

(which is typically the minimum monthly payment), you would save $961 in interest and 18 months of payments over allocating 3% to each balance.

Transfer high-rate debt to lower-rate cards. Consolidating credit card debts to a single, lower-rate card saves more than postage and paperwork. It also saves in interest costs over the life of the loan. Comparison shop for the best rates, and beware of "teaser" rates that start low, say, at 6%, then jump to much higher rates after the introductory period ends.

You can find a list of low-rate cards online from CardTrak at www.cardtrak.com.

If you can only find a card with a low introductory rate, maximize the value of that low-interest period. By paying off your balance aggressively, you will reduce the balance more quickly than you will when the rate goes up.

You can also contact your current credit card companies to inquire about consolidation and lower rates. Competition in the industry is fierce, and many companies are willing to lower their rates to keep their customers. Even a percentage point or two can make a difference with a sizable balance.

Borrow only for the long term. The best use of debt is to finance things that will gain in value, such as a home, an education, or big-ticket necessities, like a washing machine or a computer, that will still be around when the debt is paid off. Avoid using your credit card for concert tickets, vacation expenses, or meals out. By the time the balance is gone, you'll have paid far more than the cost of these items and have nothing but memories to show for it.

By analyzing your spending, controlling expenses, and establishing a plan, you can reduce -- and perhaps eliminate -- your debt, leaving you with more money to save today and a better outlook for your financial future.

SUMMARY

- Consumer debt is rising in the United States.
- If your nonmortgage debt exceeds 20% of your take-home pay, or if your monthly mortgage/rent payments exceed 30% of your monthly take-home pay, you may be overextended.
- The first step in eliminating debt is to establish a budget that allows you to trim expenses.
- To reduce debt, begin by paying down your highest-rate credit cards and consider

• •

- consolidating high-rate debt to lower-rate debt.
- Use loans and credit cards for things that have long-term usefulness or that will appreciate in value, not short-term needs like vacations or meals out.

CHECKLIST

- Set aside 30 minutes during the next week to brainstorm ways you can spend less and save more.
- Create or update your household budget.
- Make a list of purchases you could eliminate each month, such as unnecessary magazine subscriptions, unused health club memberships, etc. Use the savings to pay down a debt.
- Make a list of your high-interest account balances and then start shopping around for a low-rate account into which you can transfer and consolidate them.