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Plan to Pay Creditors and Protect Family Welfare

Barbara R. Rowe
Utah State University

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PLAN TO PAY CREDITORS AND PROTECT FAMILY WELFARE

Barbara R. Rowe, Ph.D.
Professor and Family Resource Management Specialist
Utah State University[1]

Many circumstances can lead to a loss or drop in income and you may be caught unprepared, with a seemingly endless list of bills to be paid. When this happens, you want to protect your family's welfare but you will also have to deal with your creditors. It's important that you not leave the decision-making to others, or to chance. Pretending you have no money problems won't make the problems go away. You and your family must face the situation honestly. Openly discuss where you are financially with all family members, even children. When children are not included in planning and discussion of spending changes, they may develop unrealistic fears. They may think they are somehow bad or the cause of the problem. If family members have a voice in the tough choices that must be made, they will be more willing to follow through on them.

You will want to talk to your creditors. Before you do, you need to determine how much money you owe and how much money you have to pay your bills. You can use worksheet 1, "Debts Owed" to help you. Figure out how much income you can count on each month and how much you need to pay for your essential monthly living expenses. How long is your present financial situation likely to last? What assets (savings, items that could be sold) do you have that could be used to pay off your debts? Then decide which bills must be paid first.

Who Gets Paid First?

You are legally obligated to pay all your creditors. If you can't pay all your bills, you need to decide how much to pay and to which creditors. One way to decide is to divide all the available money and pay every creditor a share of what you owe. This is probably the fairest way, but it doesn't always work because each creditor must agree to reduce the amount they receive and extend the payment period.

What will affect your family's health and security the most? A second method is to determine which creditors receive the most money. Think about the worst consequences for your family if certain debts aren't paid or if less were paid than the amount due. What will affect your family's health and security the most? Usually rent or mortgage payments, utilities, food, transportation, and medical insurance take

[1]Adapted from *When Your Income Drops*, written by Barbara Rowe and Denise Schroeder, Purdue University Extension Service, West Lafayette, IN 47906.

priority. Don't be tempted to let medical insurance slide when money is tight. If anyone in your family becomes ill, uninsured medical costs could be devastating.

What will you lose if the bills aren't paid? You can lose your possessions if the creditor holds the title of the property as security for the loan. Sometimes furniture and large appliance loans are secured loans. If you aren't sure which loans are secured, check the credit contract. Unsecured debts may have to take lower priority temporarily, although you are obligated to pay them too.

How much do you still owe on the loan? Determine how much you have paid on each loan or contract and how much you owe. If you have only one or two payments left to make on a loan, it's probably a good idea to finishing paying it, getting that debt out of the way. You may be able to return newer items or sell them to pay off the debt. If you choose to voluntarily surrender the item, you'll still be required to pay the difference between the market value of the item and the amount remaining on the loan. But getting out from under some of your debts can reduce the pressure you feel.

What interest rate are you paying? Credit card firms charging 1.5% interest per month would receive 18% interest per year on the unpaid balances. If you have a loan with a lower interest rate, you may decide to pay off the higher-interest credit card balances first, to reduce the amount of finance charges you are paying. Check with your local Extension office for information about a computer program, "PowerPay," that will help you determine different options and the costs associated with each option. Until your financial situation improves, destroying your credit cards and closing your accounts may be a good idea. At least put credit cards away in a safe place so you are not tempted to use them.

Worksheet 1: **Debts Owed**

Creditor's name and account number	Is debt secured? If so, by what?	Total owed	Interest rate	Payment due date	Date and amount of last payment	Has legal action been taken

What will happen to you if you don't pay the bill on time? Is there a "grace period" before the creditor takes action to collect? Is there a penalty or charge for a late payment? Will the remaining balance need to be paid in full if you miss a payment? Will your utilities be disconnected or will you be evicted? If you fail to repay a debt to a family member, will there be hard feelings?

What legal action has been taken? If you do not want your wages garnished or the item repossessed, pay the debt back as soon as possible.

Contacting Your Creditors

Once you have calculated how much money your family has for monthly living expenses (see "Setting Spending Priorities" in this series) and for paying off debts, decide how much you can pay each creditor based on priorities you determined while answering the previous questions. Put this repayment plan in writing. Now you are ready to contact each of your creditors to explain your situation and work out a solution. Be prepared to explain the reason you cannot pay, your current income and prospects for future income, your other obligations, your plans to bring this debt up-to-date and the amount you will be able to pay each month.

Don't wait for your creditors to contact you. They'll be more likely to work with you if you contact them first. Your past experiences with creditors are important. If you have consistently paid bills when due, your creditors will be more cooperative than if you have frequently been late or didn't make regular payments. Creditors are in the business of lending money and/or providing services. They want to keep your business, but they also want to get paid. Most creditors will work with you to adjust your payments because they would rather receive smaller payments on a regular basis than to begin expensive collection proceedings.

It's hard, but visit local creditors in person. Visit the loan officer at your bank or credit union, the credit manager of local stores, and the billing office of your dentist, physician, clinic, or hospital. Some businesses, such as utility companies, have special counselors for customers who can't pay their bills. These counselors can help you set up a budget plan to even out your payments during the year. They can also tell you if you qualify for fuel assistance or any other available programs.

Contact out-of-town creditors by phone or letter (see sample below). If you telephone, write down the name and title of the person to whom you talked. Follow the conversation with a letter, spelling out the agreement between you and the creditor. Keep copies of your correspondence as well as any reply.

As you negotiate with each of your creditors, don't agree to any plan simply to get off the hook. Establish a repayment plan that is acceptable to both you and the creditor. If you fail to follow through on a plan that you and your creditor agree upon, creditors will be less understanding. If you fail to make the payments, creditors may hire a collection agency to make you pay.

Here are some alternatives to consider when negotiating with your creditors:

- Reducing the monthly payment
- Refinancing the loan
- Deferring a payment for a short time if you expect your income will increase soon
- Reducing or dropping late charges
- Paying only interest on the loan until you can resume making monthly payments
- Voluntarily surrendering or giving back an item purchased on credit
- Selling the item and using the cash to pay or partially pay the debt (you are still responsible for any remaining balance)

Not all creditors will be willing to accept alternatives. If you owe a large amount of money, and if your creditors won't accept reduced payments or a negotiated plan, you may consider taking a debt consolidation loan. You may have to consider more extreme alternatives such as Chapter 13 bankruptcy, or as a final resort, Chapter 7 bankruptcy.

Debt Consolidation

Some people prefer to work out their own spending plans and their own arrangements using a debt consolidation loan. The objective of this type of loan is to combine numerous monthly bills into one payment. You arrange for one large loan, pay off all your creditors and make one monthly payment to the lender.

This type of loan may be useful, under certain circumstances, when you are having trouble meeting current obligations. In some instances, you can use a home equity loan for debt consolidation. However, if you are unable to repay a home equity loan, you lose your house.

With a debt consolidation loan, your monthly loan payment is less than the total of individual debts you had before. You should be aware, though, that commercial debt consolidation and home equity loans cost money and almost always extend the life of your debts. Sometimes it takes twice as long to pay off a consolidation loan than it would have taken to erase each bill individually.

If you are considering a consolidation or home equity loan, contact several financial institutions and ask what annual percentage rate (APR) they would charge on a loan for the amount you need. Ask what finance charges are associated with the loan. If you choose this route, be sure to shop around for the best terms. And don't be fooled into thinking that a consolidation or home equity loan has solved your financial troubles. You will still need to exercise financial care until your income rises again.

Bankruptcy

If your financial affairs have deteriorated beyond repair, bankruptcy is a last resort. Bankruptcy laws were designed to release people from crushing debts and spare them undue harassment by creditors. There are two choices for bankruptcy–Chapter 13 and Chapter 7. Chapter 13 is designed for persons who wish to pay their bills, and have a source of regular income. Chapter 13 allows you, under the supervision of a bankruptcy trustee, to work out a whole or partial repayment plan, if creditors agree. Payment schedules can stretch for a period of three to five years, during which time payments are made to the court. Interest charges stop on the date of the filing.

People often refer to Chapter 7 as "straight" or "liquidation bankruptcy." Under Chapter 7, a petition is filed for bankruptcy, which includes a list of all assets and liabilities. You are allowed to keep some property, known as exempt items. The rest of your property, with the exception of certain personal possessions, is sold and the money is used to pay your creditors. Chapter 7 theoretically wipes the financial slate clean. However, you will still owe any back state and federal taxes, child and spousal support, and student loans.

If you're considering bankruptcy, you will have a number of decisions to make. Is bankruptcy the best solution to your debt problem? Bankruptcy will remain on your credit record for ten years. If you file bankruptcy you may not be able to obtain credit for necessary purchases, such as a car, even after your financial situation improves. Once you have filed for bankruptcy, you are not able to file again for seven years.

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Sample Letter to Creditors

Use this example as a guide when writing or talking to creditors. Fill in the specifics of your family's situation in place of the information in parentheses.

Date

Company Name
Street Address
City, State, Zip
Attention: Delinquent Account Representative
Subject: Your Name
Your Account Number

The purpose of this letter is to inform you that (I/ my family) am having some budgeting and debt problems. I am having trouble making my minimum monthly payment as a result of (a family crisis, a recent job loss, seasonal unemployment, etc.). I hope we will be able to agree upon an acceptable debt restructured payment plan.

I have taken a careful look at our financial situation. We have set up a realistic minimum budget for our living expenses and have developed a debt restructured payment plan. I am hoping you will accept a reduced payment. Amounts will be increased as soon as possible until the debt is totally repaid.

We owe (12 creditors over $7,500). Our asset value is less than ($3,000). Our only assets are (a car with Blue Book value of $1,000, some home furnishings worth $1,500 and our family's clothing). Our monthly income is ($708). We have ($242) left over after basic living expenses for debt repayment. I would like you to accept a partial payment of ($50) per month to repay our obligation. You may expect the first payment on (date).

I hope you will find this plan acceptable. I look forward to your letter of acknowledgment. Thank you.

Sincerely,

Your Name
Your Address
Your City, State, Zip