

Getting Through Tough Times

Deciding Which Bills to Pay First

GTTT-4

What do you owe? What's most important? How do you decide?

When you don't have enough money to cover your family's basic living expenses and pay all of your creditors, you face some difficult financial decisions.

It may be tempting to use credit cards, take out a home equity loan or borrow money to pay bills. But taking on more debt is generally not a good idea. Unless your situation turns around quickly, it only puts you further behind and creates bigger problems. Instead, focus on cutting your spending and working with your creditors to reduce your payments until your situation improves.

When family income is reduced, your spending habits must change. The sooner you change, the more likely your financial problems can be lessened. Your family should be part of the decision-making process, since their cooperation is essential to carry out the plans.

Sizing Up Your Situation

When your bills are more than you can pay, you need to contact the people to whom you owe money—your creditors—and explain your situation. Creditors are usually willing to work with you if you contact them before you get behind in your payments.

Before you can talk to your creditors, you need to take a hard look at your situation and make some decisions about how much, and when you can pay each creditor. Answer these questions:

- How long is your present financial situation likely to last?

- How much income can you count on each month?
- How much money is needed to cover your family's essential monthly living expenses?
- How many creditors do you owe, and what is the total amount you owe? Completing the worksheet *DEBTS OWED* can help you get a clearer picture of what and how much you owe.
- What assets (savings, items that could be sold) do you have that could be used to pay off your debt?
- What debts are the most important to repay first?
- What debts could be satisfied by voluntarily surrendering, or giving back, the item?

Other fact sheets in this series, *Setting Spending Priorities*, *Strategies for Spending Less*, and *Making the Most of What You Have*, can help you to answer these questions. They are available from your local Cornell Cooperative Extension office.

Who Gets Paid First?

You are legally obligated to pay all of your creditors. If you can't pay all your bills, you must decide how much to pay to each creditor. One way is to divide the money available and pay every creditor a share of what you owe them. This may seem fair, but it doesn't always work because each creditor must agree to reduce the amount they receive and extend the payment period. It also doesn't take into account that some bills may be more important to pay than others. To help you decide which bills must be paid immediately and which ones can wait, ask yourself these questions:

What will affect my family's health and security the most?

Usually food, housing, utilities, transportation and medical care take priority. Unless you are planning to move to less expensive housing, keeping up with your mortgage or rent payments is essential to avoid losing your house or getting evicted. See the fact sheet *Keeping a Roof Overhead* for suggestions on what to do if you can't make your mortgage, rent or utility payments.

If you need a vehicle to keep or get a job, paying the car loan or lease payment may be a priority. Missing payments on a car or truck loan can result in repossession since the vehicle is the security for that loan. If you lease a vehicle, check your lease for penalties that result from default or early termination of your lease. New York law requires you to carry minimum car insurance. See the fact sheet, *Meeting Your Insurance Needs*.

Be careful about letting medical insurance slide when money is tight. If anyone in the family becomes ill, uninsured medical bills could be devastating. If you've lost your job and had medical insurance through your previous employer, you should receive a notice about continuing your coverage. If you can afford to pay the premium, continuing the insurance is generally a good idea, especially if someone in your family has an existing medical condition that requires care. Often the only way to avoid restrictions for a pre-existing condition is to maintain coverage with an existing insurer. For additional suggestions, see the fact sheet on *Meeting Your Insurance Needs*.

What will you lose if the bills aren't paid?

In addition to your house or vehicle, other property can be lost if you don't make payments. Loans to purchase furniture, appliances, boats, recreational vehicles, and electronic equipment often include the item as security for the loan. If you are unsure which loans are secured, check the credit contract. Even though secured, repaying these loans may have a lower priority, especially if you can live without the item.

How much do you still owe on the loan?

Determine how much you have paid on each loan and how much you owe. If you have only one or two payments to make on a loan, it's probably a good idea to finish 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 give back 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. Getting out from under some of your debts can reduce your stress.

Do you owe child support, back taxes, or student loans?

Failure to pay a child support order can have serious consequences. You may be held in contempt of court, have your driver's license revoked, liens placed on your property, your tax refund intercepted, or be ordered to jail. If your income has dropped sharply, you may be able to get the order modified. Orders are generally not reduced retroactively. If you don't get the order modified and fail to make child support payments, you are responsible for all unpaid support obligations plus interest. Contact your county child support office for more information.

If you owe unpaid income taxes, the IRS may seize your paycheck, bank account, house, or other property. If you can't pay the total amount due, contact the IRS to request a monthly repayment schedule.

You may be able to have payments on federal student loans deferred—no payments required—during periods of unemployment or financial hardship. But you can't qualify for a deferment once your student loan is in default. For more information on student loans, request a copy of *The Student Guide* from the Federal Student Aid Information Center at 1-800-433-3243. Information including *A Guide to Defaulted Student Loans* is also available on the Internet at <http://www.ed.gov/offices/OPE/Students>. Interest you pay on your student loan during the first 60 months after you begin loan payments is a tax deduction on the front page of IRS Form 1040.

Do you have outstanding balances on credit card accounts?

Making minimum monthly payments on your credit cards and department store charge cards will keep these accounts current, and avoid negative reports on your credit report. However, paying only the minimum—usually 2-3 percent of the outstanding balance—will increase your finance charges and extend the time it takes to pay off the balance. Compare interest rates among credit cards, banks and credit unions to make sure you are paying the lowest rate available to you.

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.

If you are having difficulty paying credit card debt, you may find it helpful to get assistance from a non-profit Consumer Credit Counseling Service. Call the National Foundation for Consumer Credit (NFCC) at 1-800-388-2227 for the nearest consumer credit counseling program. Their web site is <http://www.nfcc.org>.

Also, ask your local Cornell Cooperative Extension office for the fact sheet series, *Financial Fitness*, available in both English and Spanish.

Is a consolidation loan a good idea?

Loan consolidation is designed to pay off several financial obligations under one debt. While this may seem like a good idea, you should be aware of several consequences before making a decision to consolidate debts.

What are the possible problems?

1. The long-term cost of debt consolidation loans is usually more expensive because the repayments are spread out over a longer period of time.
2. Some debts that may have originally had no interest, such as medical bills, will now be included.
3. There may be closing fees or balloon clauses included in the contract that are not clearly explained.

4. There may be a temptation to actually increase personal debt due to the temporary feelings of freedom that accompany reduced monthly obligations.
5. If new purchases are made to maintain the previous lifestyle, financial disaster and increased anxiety are only postponed.
6. Homes are used as collateral to secure the loan if a second mortgage or home equity loan is used—putting the family residence at risk if the problem of mismanaged money is not first solved.

What are the alternatives to loan consolidation?

- Increasing income
- Reducing expenses
- Adjusting some debts
- Improving management
- Increasing family cooperation

Taking time to think through your situation and make positive changes will be a valuable investment in your long-term financial well-being.

What about your credit record?

Late payment and nonpayment of bills is recorded on your credit record. That can damage your ability to get credit—or increase the cost of credit. That's why it's important to contact all of your creditors immediately if you cannot pay your bills. If you can pay something on each debt as agreed, it's less likely that your financial problems will be reported on your credit record.

Your Repayment Plan

Once you have determined how much money your family has for monthly living expenses and for paying off debts, decide how much you can pay each creditor. Work out a repayment plan that shows how much you plan to pay on each bill. Put this plan in writing.

Now you are ready to contact your creditors to explain your situation. Tell each one how much you can pay and when you will pay them. For ideas about

what to say when you contact your creditors by phone or by letter see the fact sheet in this series, *Talking with Creditors*.

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 government assistance programs that help with your energy or medical bills.

Making Your Plan Work

After you have worked out a repayment plan with your creditors, follow through with it. Make the payments you promised. If you fall behind on your new commitments, creditors will be much less understanding. If you fail to pay as promised, creditors may hire a collection agency or start legal action against you.

Pretending you have no money problems won't make the problems go away. Face the situation honestly. Openly discuss spending decisions with all family members. This will help everyone understand the changes and sacrifices needed for your plan to succeed.

Remember: No matter how bad your situation may be, you can't afford to ignore your bills and creditors. **Prompt action is very important.** Take charge. Let your creditors know you are having trouble **before** you miss payments and the situation becomes worse.

World Wide Web Resources

National Foundation for Consumer Credit (NFCC)

<http://www.nfcc.org>

References

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Leonard, Robin. *Money Troubles: Legal Strategies to Cope with Your Debts*. Nolo Press: Berkeley, CA. 1996.

Sheldon, Jonathan and Gary Klein. *Surviving Debt: a Guide for Consumers*. National Consumer Law Center: Boston. 1996.

Getting Through Tough Times is a multi-part series for individuals and families experiencing personal/financial crises.

Contact your local Cornell Cooperative Extension office for copies of other fact sheets in this series. The address and phone number can be found in the yellow pages of your phone book under "governmental offices – county."

Worksheet—Debts Owed

Creditor Balance	Amount past due	Amount monthly payment	Interest rate	Is debt secured? If so, by what?	Total owed

Total \$ _____



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