Overcoming Debt Problems

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One of the first steps in overcoming debt problems is admitting that there is in fact a problem. Here are some warning signs of debt trouble:

- Paying only the minimum on credit cards or loans.
- Using credit to pay for everyday expenses – like groceries or gas.
- Making payments late.
- Paying so much on credit cards and loans that you're unable to save for retirement.

If you constantly pay only the minimum on credit card accounts, here's an example of what it can cost you:

	Pay minimum 2% of balance	Pay extra monthly
Credit card balance	$3,000	$3,000
Interest rate	19% APR	19% APR
Monthly payment	$60 first month; minimum thereafter	$80
Time to pay off	35 years	5-8 years
Interest you pay	$9,284	$1,560

Tips for Getting Out of Debt

- Make a budget. Cut expenses – for example a weekly family dinner out, and put the money you save toward paying off debt.
- Cut up credit cards. Commit to spend less than you earn.
- Avoid nonessential purchases – like furniture – if you can't buy without using credit.
- Make all payments on time. Set up payment reminders through online bill pay.
- Make more than the minimum payment on at least one account, until it is paid off.
- When one is paid off, redirect payment to another account.
- Focus on accounts charging the highest rates of interest first.
- Don't be afraid to ask for help. Talk to a friend or family member who understands finances or a nonprofit credit counselor.
- Use resources available within the community
- Don't fall for companies who claim they can repair bad credit for a fee

Improving Your Credit Score

To improve your credit or FICO score, it is helpful to know what contributes to your score and steps you can take related to each category.

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Payment History – 35% of your credit score

- Pay on time! Delinquent payments, even if only a few days late, and collections can have a major negative impact on your credit score. If you have missed payments, get current and stay current. The longer you pay your bills on time after being late, the more your credit score should increase.

Amount You Owe – 30% of your credit score

- Keep balances low on credit cards and other "revolving credit." High outstanding debt can affect a credit score.
- Pay off debt rather than moving it around. The most effective way to improve your credit score in this area is by paying down your revolving (credit cards) debt. In fact, owing the same amount but having fewer open accounts may lower your score.
- Don't close unused credit cards as a short-term strategy to raise your score.
- Don't open a number of new credit cards that you don't need, just to increase your available credit. This approach could backfire and actually lower your credit score.

Length of Credit History – 15% of your score

- If you have been managing credit for a short time, don't open a lot of new accounts too rapidly. New accounts will lower your average account age, which will have a larger effect on your score if you don't have a lot of other credit information. Also, rapid account buildup can look risky if you are a new credit user.

New Credit – 10% of your score

- Do your rate shopping for a given loan within a focused period of time. FICO scores distinguish between a search for a single loan and a search for many new credit lines, in part by the length of time over which inquiries occur.
- Re-establish your credit history if you have had problems. Opening new accounts responsibly and paying them off on time will raise your credit score in the long term.
- Note that it's OK to request and check your own credit report. This won't affect your score, as long as you order your credit report directly from the credit reporting agency or through an organization authorized to provide credit reports to consumers.

Types of Credit Used – 10% of your score

- Apply for and open new credit accounts only as needed. Don't open accounts just to have a better credit mix – it probably won't raise your credit score.
- Have credit cards – but manage them responsibly. In general, having credit cards and installment loans (and paying timely payments) will rebuild your credit score. Someone with no credit cards, for example, tends to be higher risk than someone who has managed credit cards responsibly.
- Note that closing an account doesn't make it go away. A closed account will still show up on your credit report, and may be considered by the score.

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Raising your score after a poor mark on your report or building credit for the first time will take discipline, but with patience it can be done

Is there much of a difference between a good and bad credit score? Look at this example that shows the difference between an excellent and not-so-good credit score:

- You buy a car for $12,000 and put $2,000 down.
- You need a loan for $10,000.
- Your loan is for 48 months.

Score	700 or higher	600 or lower
Loan amount	$10,000	$10,000
APR	5.00%	12.50%
Monthly payment	$230	$267
Total interest paid	$1,055	$2,753
Your savings after 48 months	$1,698	

Consider the difference good credit can make over a lifetime!

Adapted from Old National Bank Real Life Finance financial education program.