



8 Ways to Pay Off Debt

Description

You can throw the reminders in the Cuisinart or chuck them into a garbage can, but that won't make the debt go away.

Debt hovers like a carrion bird over a dying beast, with annual rates of 20% or more compounded monthly, month in and month out. You can't wish it away. But you can pay it down with determination, our [personal finance resources](#), and the good graces of a few wealthy relatives (see tip No. 5). Here are nine ways to get out of debt:

1. Pay more than the minimum

First, break the habit of paying only the [minimum payment](#) required each month. Paying the minimum — usually 2% to 3% of the outstanding balance — only prolongs the agony. Besides, it's precisely what the banks want you to do. The longer you take to repay the charges, the more interest they make, and the less cash you have in your pocket. Don't play their selfish game.

Instead, bite the bullet and pay as much as you can each month. If your minimum payment is \$100, double that to \$200 or more. Examine your normal expenses — you can find the money. Skip eating out at lunch, and bring it from home instead. Eliminate desserts. Give up happy hour. We all have "luxuries," and you know what yours are.

Here's a great tip to make cutting your spending less painful: consider what's really important to you. If you *love* burritos, but don't care all that much about coffee, then don't stress about cutting out your burrito at lunch. Instead, make your coffee at home, rather than paying more for it at a coffee shop. Likewise, if you love to play golf, but don't care that much about travel, then keep your golf outings on the calendar, but economize on your travel plans. (Note: depending on how much debt you have, it may be best to cut down on everything for a while!)

Make a few sacrifices, and you will find the extra dollars needed to increase your debt repayments dramatically. Those increased payments will save you hundreds, if not thousands, in interest payments. Plus, you will get out of the hole you've dug for yourself much more quickly. Is it fun? No. But it sure beats living a hand-to-mouth existence, fearing bills each month.

2. Snowball your debt payments

Take a long, hard look at all your [credit cards](#). Pay particular attention to the one with the lowest interest rate. Have you reached the maximum limit on that card? If not, consider transferring a higher-interest bill to that one. Many credit cards permit this, and it's positively Foolish to trade an 18% debt for one at 12%.

If your entire balance is too large to fit on one low-interest card, pay at least the minimum amounts due on all of your cards except one. Funnel the majority of your debt repayments into that one credit card, and pay it off as quickly as possible. When the balance on that card reaches zero, move on to the next with the same aggressive repayment plan.

Lather, rinse, and repeat. This method of repayment is aptly called "snowballing." As your debts decrease, the amount of money you have to attack them increases. Your payments snowball until all of your debt is pummeled. Pretty neat, eh?

And if your credit card interest rates are high and you're not getting much in return for that, it may be worth checking our picks for [Canada's best credit cards](#) to see if you can put a better card to work.

3. Cash out your savings account

You could cash out your savings and investments and use the proceeds toward debt repayment. Yeah, no one wants to do that. But sometimes it's just Foolish to do so. Even when debt interest is at 12%, your investments would have to pay more than 18% before federal and state taxes to equal that outflow of dollars. We doubt the dollars in your savings account are earning anywhere near that rate of interest. Pay off the debt, and it's the same as getting that 18% return without any risk on your part. The higher the interest rate on your debt, the more attractive repayment versus investment becomes.

If you want to do this in the most Foolish way possible, treat these withdrawals from your savings and investments as loans to yourself. Once you have your high-interest debt paid down, set to work paying yourself back, and get those savings accounts back to where they were.

4. Borrow against your life insurance

Do you have life insurance with a cash value? If so, borrow against the policy. Yes, you're borrowing your own money. But the interest rate is typically well below commercial rates, and you can take your time repaying the loan. Do repay it, though. If you die before it's repaid, the outstanding balance plus interest will be deducted from the face value of the policy payable to the beneficiary. While that seems a small price to pay to get out of debt now, it could be burdensome to your loved ones should you sleep the eternal sleep before paying it back.

5. Finagle family and friends

Perhaps your family or friends could float you a loan. Who else knows, trusts, and loves you like they do? Unless you're really the black sheep of the flock, chances are you'll get a very favourable interest rate. They may even tolerate a late payment or two.

Of course, if you want to maintain the relationship, it's best to keep things on the straight and narrow by using a written agreement. You should clearly establish the interest and repayment schedule in writing to avoid misunderstandings and hard feelings. And it goes without saying that you must be scrupulous about adhering to that schedule. Otherwise, you can forget the family reunions and birthday presents.

6. Get a home equity loan

Do you own your own home and have equity that's accumulated through the years as you've paid off the mortgage? If so, now's the time to consider a home equity loan line of credit (HELOC) for the maximum amount possible.

A HELOC acts in a similar manner to the life insurance idea above. The danger here is falling into a common trap. Many get an HELOC, pay off existing debt, and then ring up the charges on the credit cards all over again. Now they have the HELOC to repay on top of the credit cards. The hole just got much deeper. Fools use the HELOC to pay off the credit cards, and then keep them paid off until the HELOC is repaid.

7. Renegotiate terms with your creditors

OK, you've done all you can. Savings are gone; relatives have been tapped out; you don't have a life insurance policy or home to borrow against. You feel like you're against that proverbial wall. The money just isn't there. Is bankruptcy the only way out? No way. Try pulling an ace out of your sleeve prior to taking that step. What ace? The *threat* of bankruptcy, of course.

Let your creditors know your situation. Tell them that if you are unable to renegotiate terms, you'll have no other recourse but to declare bankruptcy. Ask for a new and lower repayment schedule; request a lower interest rate; and appeal to their desire to receive payment. Faced with the prospect that you may resort to such a drastic step, creditors will do what they can to protect themselves against a total loss.

Indeed, many will negotiate away the farm before they'll write off your debt. As lawyers love to say, *everything* is negotiable. Therefore, what do you have to lose, except time? It's worth a try. And if you don't wish to do this yourself, organizations exist that can do it for you.

8. As a last resort, file bankruptcy

What if you decide you can't pay down your debt using any of the methods listed above? What should you do? The absolute last resort is bankruptcy.

Within Fooldom, we firmly believe everyone has a moral obligation to repay their debts to the utmost of their ability. There are times, though, when repayment may be impossible. In those cases, bankruptcy may be the only available course of action. Nevertheless, be aware of the significant drawbacks the most obvious of which is that your credit history is basically reset to zero, thus ensuring you will have a tough time obtaining credit you can afford anytime soon. Additionally, as odd as it seems, it costs money to file for bankruptcy. Attorney and court filing fees cost in the hundreds of dollars, and they

must be paid to obtain the relief sought.

If bankruptcy is the right decision, be sure to take some time to try to understand what led to the debt problem in the first place. Educate yourself about [personal finance](#). Be your own champion and do all you can to not end up in the same situation again.

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