Knee Deep In Debt?

The first in a three part series on using consumer laws to solve financial woes.

Having trouble paying your bills? Afraid to answer the phone because it might be a debt collector? Are you worried about losing your home or your car?

You're not alone. Many people face financial crises at some time in their lives. Whether the crisis is caused by personal or family illness, the loss of a job, or simple overspending, it can seem overwhelming, but often can be overcome. The fact of the matter is that your financial situation doesn't have to go from bad to worse. If you or someone you know is in financial hot water, there is a way out. This is the first article in a three part series to give advice on how to get out of debt, deal with debt collectors, and repairing your credit history.

Self Help Options: Realistic Budgeting, Credit Counseling, and Debt Consolidation

The first step towards taking control of your financial situation is to do a realistic assessment of how much money comes in and how much money you spend. Start by listing all your income from all sources. Then, list your "fixed" expenses—those that are the same each month—such as your rent or mortgage payments, car payments, or insurance. Next, list the expenses that vary, such as entertainment, recreation, or clothing. Writing down all your expenses, even those that seem insignificant, is a helpful way to track your spending patterns, identify the expenses that are necessary, and prioritize the rest. The goal is to make sure you can make ends meet on the basics: housing, food, health care, insurance, and education.

Contact your creditors immediately if you are having trouble making ends meet. Tell them why it is difficult for you, and try to work out a modified payment plan that reduces your payments to a more manageable level. Don't wait until your accounts have been turned over to a debt collector. At that point, the creditors have given up on you.

If you are not disciplined enough to create a workable budget and stick to it, can't work out a repayment plan with your creditors, or can't keep track of mounting bills, consider contacting a credit counseling service. Your creditors may be willing to accept reduced payments if you enter into a debt repayment plan with a reputable organization. In these plans, you deposit money each month with a credit counseling service. Your deposits are used to pay your creditors according to a payment schedule developed by the counselor. Debt repayment plans usually cover only unsecured debt. Your auto and home loan, which are considered secured debt, may not be included. You must continue to make payments to these creditors directly.

You may be able to lower your cost of credit by consolidating your debt through a second mortgage or a home equity line of credit. Think carefully before taking this on. Many of these loans require your home as collateral. If you can't make the payments—or if the payments are late—you could lose your home.

Bankruptcy: The Option of Last Resort

Personal bankruptcy is generally considered the debt management option of last resort because the results are long-lasting and far-reaching. A bankruptcy stays on your credit report for 10 years, making it difficult to acquire credit, buy a home, get life insurance, or sometimes, get a job. However, it is a legal procedure that offers a fresh start for people who can't satisfy their debts.

There are two kinds of personal bankruptcy: Chapter 13 and Chapter 7. Each must be filed in federal court.

Chapter 13: Also known as reorganization, Chapter 13 allows debtors to keep property, like a mortgaged house or car, that they might otherwise lose. Reorganization may allow you to pay off a default during a three-to-five year period, rather than surrender any property.

Chapter 7: Known as straight bankruptcy, Chapter 7 involves liquidation of all assets that are not exempt in your state. Exempt property may include work-related tools and basic household furnishings. Some of your property may be sold by a court-appointed official or turned over to your creditors. You can file for Chapter 7 only once every six years.

Both types of bankruptcy may get rid of unsecured debts and stop foreclosures, repossessions, garnishments, utility shut-offs, and debt collection activities. Both also provide exemptions that allow people to keep certain assets, although exemption amounts vary among states. Note that personal bankruptcy usually does not erase child support, alimony, fines, taxes and some student loan obligations.

How do you know which option is best for you? It depends on your level of debt, your level of discipline, and your prospects for the future. Stay tuned to the next article to learn about your rights when dealing with debt collectors.

--Article based on information published by the Federal Trade Commission. For more information on this and other subjects, contact them at (202) 326-2222.