GETTING RID OF DEBT: WHAT IS THE BEST OPTION FOR YOU?

What debt are we talking about? What are the methods to get rid of debt? What are the benefits of each method? What are the downsides? How do I determine if I am eligible for a particular method? How do I determine which method is best for me?

It is important to look at all of your debts when considering how to manage the debts and get them all paid or removed. For example, it might not be prudent to ignore significant credit card debt while you try to pay back the IRS. While many of the following methods work for someone in default on their payments, these methods also can be considered by someone who is making their payments, but is struggling to reduce their debt.

The options to handle debt are:

A. Keep paying until the debts are paid off.
B. Take out a consolidation loan to cover the debts.
C. Negotiate a monthly repayment plan to save some of the principal and interest (debt consolidation).
D. Negotiate lump-sum payoffs with each creditor.
E. Take a reverse mortgage to obtain money to pay the debts.
F. Do nothing (don't pay, don't settle, and don't file bankruptcy).
G. File bankruptcy (chapter 13 repayment plan to restructure the debts, or a chapter 7 resulting in a quick discharge of many debts).

A. **Keep paying until the debts are paid off**.

-Benefits: Becoming debt free can provide financial options for the rest of your life. If you have the ability to increase your income, perhaps through a second job, and also cut your expenses to bare necessities, you may be able to pay off all of your debt within a short time. You need to be able and willing to make serious sacrifices to do this. You must be quite disciplined to stick to a budget. You could potentially pay off everything, not just the credit cards. That means paying off car loans, bank loans, and even mortgages. There are resources to help you to develop a budget and plan to pay off your debts. If paying off all of your debts is not feasible, then perhaps you start with the credit cards. The most cost-effective way to pay off credit card debt is to pay something beyond the minimum payment, and as soon as the smallest credit card is paid off, then roll the payment you had been paying on that card into the payment on the next-highest card, and so forth as each card is paid off. This method works, but requires strict financial discipline. You certainly would have to completely stop using your credit cards.

-Downsides: You need to be able to maintain a tight budget during the repayment, and you may need additional income to be able to accelerate the payments.

-May not be realistic if you are also struggling with other debt besides credit cards.

-No formal eligibility requirements, but does requires the ability to maintain payments until the debts are paid.

B. **Take out a consolidation loan to pay off all of the debts**.

-Benefits: May substantially lower your debt payment. Interest may be deductible on tax return if your consolidation loan is a mortgage (ie., home equity loan). May protect your credit score.

-Downsides: If you take a home equity loan, you will be trading unsecured debt for a lien on your house. If you fail to make the loan payments, you could lose your home in foreclosure. Even though the monthly consolidation loan payment should be lower than your current monthly debt payments, the repayment term will probably last many years. You will incur costs to take a loan, especially a home equity loan.

-For this plan, obviously you need to qualify for a loan large enough to cover your debts. If you have substantial debts, or do not have significant equity in a house, you may not qualify for a loan. I am always very reluctant to recommend taking a mortgage to pay off other debts.

C. **Negotiate a monthly repayment plan to reduce interest (Debt Consolidation)**. Note: The so-called debt settlement agencies are NOT recommended (see section D below).

-Benefits of Debt Consolidation: May lower your monthly payments, and may shorten the time to pay off the debt. May not protect credit score.

-Downsides: For credit card debt, usually you must be behind on payments for the credit card companies to consider participating in a consolidation plan. Very unlikely that you could negotiate a plan without the use of an agency that handles “credit-counseling” or “debt-consolidation” to negotiate on your behalf. These agencies negotiate for a lower interest rate on credit cards, but not for a reduction of the total amount owed. I strongly recommend avoiding any company or agency that offers "debt settlement." If the company advertises that they can cut your credit card debt by 50% or more, they are selling debt settlement. Stay away.

-These consolidation plans generally only cover credit cards, and will not cover medical bills, auto repossession claims, taxes, and judgments.

-No formal eligibility requirements, but you must have the ability to make the negotiated monthly payments. The interest rate will be lower, but you will still be paying back the full debt. The repayment plans usually do not exceed five years, so if you have substantial debt, the monthly payment may be more than you can afford.

D. **Negotiate lump-sum payoffs with each creditor**.

-Benefits: Potentially saves significant amount on principal repayment (potentially a savings of 30% to 60% on credit card debt). Can usually resolve debt issues within approximately one year.

-Downsides: Spend a lot of cash. Potential tax liability for “debt forgiveness” triggered when a creditor “forgives” a portion of the debt. May affect credit score.

-No formal eligibility requirements, but the practical requirement is that you must have enough money on hand to immediately pay the settled amount. The so-called "debt settlement" agencies promise you the reduction, but since you do not have the cash ready to pay the settlement, these agencies have you pay them monthly in the hope of saving enough money to settle. The first several payments cover their fees. The basic problem is that you cannot save money fast enough to pay the settlements, and the credit card companies will not wait. Often they will sue you while you are making payments to the "debt settlement” agency, and once they sue, the "debt settlement" agency will not help you.

-Although you do not need an attorney to negotiate for you, an experienced attorney can provide advice and assistance in achieving settlements on all of your debts. Organizing the contacts with all the creditors and their collection companies is a difficult task, especially if you face numerous debts. It is essential that all of your debts are addressed so that after settlement you can go forward without worry.

E. **Take a reverse mortgage to obtain money to pay the debts**.

-Benefits: Secures the right to remain living in your home for the rest of your life without having to pay a monthly mortgage payment. If enough money is generated by the reverse mortgage, you could be debt-free from all other creditors.

-Downsides: Potentially forfeit equity in the house depending on how long you live (therefore, potentially no value to be passed on to your heirs). You will incur significant closing costs which generally will be deducted from the amount of the loan.

-There are formal eligibility requirements: obviously you must own your own home, and one of the owners must be at least 62. The amount of the loan is determined by your age, and by the value of your house. You do not make monthly mortgage payments, but you are required to pay the property taxes, insurance, and maintenance. A reverse mortgage is a very serious matter, and I only recommend considering it in very limited circumstances. It can make sense when someone can no longer afford their mortgage payment, but they really want to continue to live in their home.

F. **Do nothing (don’t pay, don’t settle, and don’t file bankruptcy)**.

-Benefits: No cost.

-Downsides: Creditors will pursue you through phone calls, letters, and collection suits. You need to be tough to put up with the harassment. Creditors will try to pursue your income and assets. This method should only be considered by someone who does not own a house, has only basic personal property, has income that is exempt from garnishment (such as social security), and has no expectations that their financial situation will improve. Be aware that bank accounts could still be restrained once a creditor takes a judgment.

-Eligibility is simply determined by the absence of assets and income that a creditor could take. Note that for someone who is “eligible” to ignore all creditors (in

other words, someone who is "judgment proof"), bankruptcy would quickly remove all creditors from their life, and protect the person from ever having to deal with collections.

G. **File bankruptcy**.

Generally speaking, individuals have two bankruptcy choices, Chapter 7 and Chapter 13. Each type of bankruptcy is designed to result in a discharge of your debts, but each type has a different process.

-Benefits of bankruptcy in general: Provides the power of federal law as a protection against creditors, and provides this protection immediately upon filing of the petition with the court. Can address almost all types of debts. No tax liability for "debt forgiveness."

-Downsides of bankruptcy in general: Negative effect on credit score (however, if you are seriously in default on your debts you probably have already affected your credit score). Possible loss of some assets. You will incur legal fees and court filing fees, but bankruptcy is almost always the least expensive way to eliminate debts.

-Benefits of a Chapter 7: Obtain full discharge of most debts within a very short time.

-Downsides of a Chapter 7: Risk of loss of some assets. Will not save a mortgage from foreclosure.

-Benefits of a Chapter 13: Can stop a foreclosure and allow you to get back on track with your mortgage. May be able to adjust loans for things you want to keep (such as cars). Often a Chapter 13 requires very little money to be repaid to unsecured creditors (like credit cards).

-Downsides of a Chapter 13: The Bankruptcy may last up to five years. There will be monthly payments based on several factors, including income, assets, and the debts. However, in most situations, the monthly payment is affordable. There are some restrictions on your personal financial matters during the bankruptcy.

-Eligibility for bankruptcy: there are formal eligibility requirements, but almost everyone is eligible to file at least one type of bankruptcy. If someone has filed before, a new filing may have particular restrictions. It is important to determine whether bankruptcy is appropriate, and if so, which type of bankruptcy would provide the most benefit. The determination on filing requires a thorough review of many factors, including the type and amount of the debts, income level, assets (those you now own and those you have transferred), and the desired goals. You are not required to hire an attorney to file bankruptcy, but a mistake in filing could cost you lots of money, or could cost you the loss of a valuable asset such as your home. The bankruptcy laws are quite technical, so only someone with experience should give you bankruptcy advice. Bankruptcy should never be taken lightly, but often it provides the only realistic and comprehensive relief for all debts.

Pre-bankruptcy planning can be used to help protect many assets from being lost in a bankruptcy filing. Such planning may include putting money into a protected retirement account, or selling an asset and using the money to take care of necessities prior to filing a bankruptcy case.

The particular method to be used to manage debt is a very personal matter. The important part is deciding to take some action. Debt does not go away on its own! You must make a plan. The decision you make may not be pleasant, but undoubtedly it will be better than ignoring the debt at the peril of your future.

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We are a Debt Relief Agency. We proudly help people file for bankruptcy under the Bankruptcy Code.