University of Illinois Extension

Getting Through Tough Financial Times

Managing Your Debt: Deciding Which Bills to Pay First

Having trouble paying your bills? Are you getting overdue notices from your creditors? Are your accounts being turned over to debt collectors? Are you worried about losing your home or car?

When you don't have enough money to cover your family's basic living expenses and pay all your bills, 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 financial 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 you don't have enough money to pay your bills and other expenses, 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 in carrying out your plans.

Sizing Up Your Situation

When you have more bills than you can afford to pay, you need to ask:

- What do you owe?
- How much do you owe?
- Which bills should be paid first?

You need to contact 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 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?
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Setting Spending Priorities, Strategies for Spending Less and Making the Most of What You Have can help you to answer these questions.

Who Gets Paid First?

You are legally obligated to pay all your bills. If you can't pay all of them, you must decide how much to pay to each creditor. One way is to divide the money you have available and pay every creditor a portion of what you owe. This may seem fair to you, but it doesn't always work. 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 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. According to Illinois law, you will also need to carry minimum car insurance.

Be careful about dropping your medical insurance even though 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 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.

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

In addition to your house or vehicle, other property can be lost if payments are not made. Check furniture, appliances, boats, recreational vehicles, or electronic equipment loans to see if the item is security for the loan. If you aren't sure which loans are secured, check the credit contract. Even if the loan is 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 still owe. If you have only one or two payments to make on a loan, it's probably a good idea to finish paying it to get that debt paid. You may be able to return newer items or sell them to pay off the debt. If you choose to do this, 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 also help to reduce your stress.

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

Failure to pay child support can have serious consequences. You may be held in contempt of court, have your driver's license revoked, or be ordered to jail. In addition, liens may be placed on your property, and you may not receive your tax refund. If your income has dropped sharply, you may be able to get the court order modified. Contact your attorney or 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, contact the Federal Student Aid Information Center at 1-800-433-3243. Or, go to http://federalstudentaid.ed.gov/ and click on *Locate/Repay Your Federal Student Loan.*

Do you have outstanding balances on credit card accounts?

Paying minimum monthly payments on your credit cards will keep your accounts current and avoid negative reports on your credit report. However, paying only the minimum—usually 2-4 percent of the outstanding balance—will not reduce your balance very quickly and extends the time it takes to pay off the balance.

Contact your credit card company and ask if they will lower your interest rate. Also, shop around and compare interest rates among companies at http://bankrate.com to make sure you are getting the lowest rate available to you.

Until your financial situation improves, don't use your credit cards. Put them 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. Contact the National Foundation for Consumer Credit (NFCC) at 1-800-388-2227 or http://www.debtadvice.org for an office near you.

The University of Illinois Extension "Credit Card Smarts" fact sheets will also give you information on choosing and wisely using credit cards. Go to http://www.ace.uiuc.edu/cfe/ccs/.

Is a consolidation loan a good idea?

Lending companies want you to think so. Making a single, lower payment may be easier and more manageable for you, but, it may take longer to pay the debt and total finance charges may not be more.

What about your credit report?

Late payment and nonpayment of bills are recorded on your credit report. They can damage your ability to get credit or increase the cost of credit. That's why contacting all of your creditors immediately if you cannot pay your bills is important. 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 to 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 see 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 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.

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