

How much debt do you have?

handout

Sometimes people ask: "How much debt is too much? Financial experts and lending institutions provide some guidelines on how much debt a person could reasonably handle compared to their income. Most people will probably not want to have more than 20% of their monthly paycheck going towards debt payments. Also, lenders will base their lending decisions on these limits and may not want to give more credit to people who already have a lot of debt. In addition, lenders may charge borrowers a higher interest rate for any new credit.

To figure out how much debt you have compared to your income (debt-to-income ratio), add up your monthly debt payments and fill in the spaces below.

- A. Total Monthly Debt Payments** \$ _____
(Include credit cards, loans, car payments, etc. Do not include a home mortgage)
- B. Household Total Monthly Take Home (Net) Pay** \$ _____
- C. Divide A) by B) X 100 =** _____ %

For example, if your total monthly debt payments equal \$400 and you take home \$1800 in your paycheck every month, divide \$400 by \$1800 = .22. To get the percent, multiply .22 x 100 = 22%. If you look in the box below, you can see that a consumer with a 22% debt limit might be feeling overextended or worried about making their payments.

Percent of Consumer Debt Compared to Net Income

Percent	Level of debt is:
10 or less	Probably a safe limit; borrower may feel little debt pressure.
11 to 15	Probably a safe limit; borrower may feel some pressure.
16 to 20	Fully extended; borrower may hope that no emergencies come up.
21 to 25	Overextended; borrower may worry about debts and making payments.
26 or more	Could be disastrous; borrower may feel desperate.

If you have a home mortgage, the percent of debt limit is different since a home is considered to be an investment, not just an expense. Use the formula below to include a mortgage:

- A. Total Monthly Mortgage Payments** (without tax & insurance) \$ _____
- B. Total Monthly Debt Payments** (not including mortgage) \$ _____
- C. Add a) + b) = Total Monthly Debt/Mortgage Payments** \$ _____
- D. Total Monthly Gross Pay** (before taxes are taken out) \$ _____
- E. Divide c) by d) x 100 =** _____ %

Financial experts usually recommend that total debt *including your home mortgage* should not be more than 35% of your gross pay or more than 50% of your take home (net) pay.

Developed in 2007 by Peggy Olive, Family Living Agent, UW-Extension Richland County, 2007. Adapted from UW-Extension Family Living Education, Consumer Credit.

What Can Happen If You Don't Pay Bills?

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If you have emergency expenses or a sudden drop in income, you may be tempted to ignore bills or credit charges. Here is what may happen if you put off paying bills:

Utilities

- Utility service may be shut off. Services such as electric, gas, or your cell phone may be turned off if you don't pay bills. Also, you may not qualify for energy assistance if you owe money to the utility company.
- A large reconnect charge may be difficult to pay later.
- Interest and fees may be charged on overdue amounts.

Mortgage

- *Default* - If you miss a mortgage payment, you will receive notice from your lender that foreclosure will begin if you do not pay by a certain date.
- *Late fees* will be added to the amount you owe.
- *Cosigner will be asked to pay* - If a relative or friend cosigned the mortgage, the lender will expect them to make the payments if you do not. Your missed payments could create serious problems for your cosigner as well.
- *Foreclosure* - If you continue to not make payments, the lender will ask the courts to auction your home so the lender can regain the money owed. If this happens, you could lose your home, all of your money invested in it, and still owe more money to your lender. You may want to consider selling your house before court action begins.

Other Creditors

- If you miss a payment, you will receive a letter reminding you that you missed a payment and asking you to pay promptly. After that, you may receive a more direct letter or get a phone call demanding payment.
- Bills will probably be turned over to an independent collection agency. At that point, you will no longer be able to negotiate with the person or company you owe money to. Collection agencies can be aggressive, but you do have certain rights. Collection agencies can't use abusive language or threaten you with violence. They can't call you at unusual hours or threaten criminal prosecution. And they can't discuss your financial situation with others.
- Creditors can take several kinds of legal action against you. These actions are often written into the sales contract you signed. If you fail to make payments, you will receive letters from a creditor's attorney warning you of the action the creditor plans to take. These actions may include:
 - *Acceleration* – the entire debt is payable at once if you miss a payment. The courts can force you to pay by seizing your property and selling it.
 - *Repossession* – the creditor can seize the item you bought or the property you used as collateral. If the sale of the property brings less than the amount you owe, you still must pay the difference.
 - *Wage garnishment* – a court order or judgment that requires your employer to withhold part of your wages and pay your creditor. The creditor can also garnish your checking or savings account if you have more than \$1000 in your account.

Government Debts

- Debts like property taxes or child support are handled differently than a loan or credit card payment.

Where Do You Start If You Can't Pay Bills?**handout**

- 1. Take action right away!**
2. Contact creditors BEFORE you miss a payment. You can reduce your chances of being harassed by creditors or collection agencies by working out solutions early.
3. At the first sign that you will not be able to make a payment, do the following:
4. Work out your new income and expenses. Use a monthly spending plan worksheet to compare your income to current expenses. This will give you a picture of your current spending and possibly places to cut back on your day to day expenses.
5. Prioritize your bills. Credit card collection agencies can be rude and persistent if you miss a credit card payment, but missing a mortgage payment could mean losing your house. Figure out what other bills are priorities to you, for example, the car payment or groceries. See "Deciding which debts to pay." After you set aside enough money for priorities, then divide the rest of your income among the other creditors and bills.
6. Contact your creditors before they contact you. When you contact creditors, you'll need to work with someone—a supervisor, accounts manager, or "loss mitigation" specialist—who can negotiate with you. When you call, this may mean getting busy signals or spending some time on hold since many others in similar situations may be calling too. If the creditor is local, make an appointment to meet with them in person.
7. Make specific and realistic offers to creditors. A creditor does not have to accept a lower payment from you, but it never hurts to ask and explain your situation. Agreements may include lower payments over a longer period (with more interest added) or payment on interest alone for a set time period. Don't make promises you can't keep.
8. Follow up with a letter detailing the arrangements you agreed to with each creditor. In the letter, write down the terms of your agreement including amount and due date, the name of the person you talked to, and the date. Keep a copy of the letter for your records. Get agreements in writing and signed by the creditor before you send in payments.
9. Contact a credit counseling agency if you need help working with your creditors. Be aware that these agencies charge a fee to help you and a debt repayment program may affect your credit rating.
10. Consider seeking legal advice. You have rights under the Consumer Protection Act. If a creditor has filed a judgment against you to garnish your wages or repossess collateral, you may want to speak with an attorney before the court date.
11. Don't take on new debt. You may be tempted to use credit cards, take out a home equity loan, or borrow money to pay bills. Unless your situation turns around quickly, more debt only creates bigger problems.

WHAT ABOUT YOUR CREDIT RATING? *Nonpayment of bills is reported on your credit record, which can damage your ability to get credit or increase the cost of credit. A prospective employer may ask to see your credit record. If you contact all creditors immediately and pay something on each debt as agreed, creditors are less likely to report problems to credit bureaus.*

Deciding Which Bills to Pay First**handout**

When you are between jobs, the paychecks may stop coming, but the bills don't. You're legally obligated to pay all debt, but when you don't have enough money to cover your monthly expenses and pay your creditors the minimum amount due, you face some tough decisions. There is no magic list of the order in which debts should be paid since everyone's situation is different. Here are some general rules about how to set priorities:

1. First, pay housing-related bills. Keep up rent or mortgage payments if at all possible. Failure to pay these debts can lead to loss of your home.
2. Pay basic living expenses next. This includes groceries and medical insurance if you can afford the premiums.
3. Pay the minimum required to keep essential utility service. Full and immediate payment of the entire amount of the bill may not be required, but you should make the minimum payment necessary to avoid disconnection if at all possible.
4. Pay car loans or leases next if you need to keep your car. If a car is needed to get to work, you will usually make the car payment the next priority after housing, food, and utilities. Your creditor can repossess your car without going through the courts first. If you keep the car, stay current on insurance payments as well to avoid additional fees, legal problems, or an overwhelming expense from an accident.
5. Make tax debts a high priority. You must pay any income taxes owed that are not automatically deducted from your wages and any property taxes if they are not included in your monthly mortgage payment. You must file your federal income tax return, even if you cannot afford to pay any balance due. The government has many collection rights that other creditors do not have. Also pay child support; these debts are court-required and will not go away. Nonpayment can result in very serious problems, including prison for nonpayment.
6. Make student loans a medium priority. In general, pay them ahead of low priority debts but after top priority debts. Since most student loans are backed by the government they are subject to special collection remedies, such as wage garnishments, seizure of tax refunds, and denial of new student loans and grants.
7. Make loans without collateral a low priority. These include credit card debts, doctor or hospital bills, other debts to professionals and similar obligations. Since you have not pledged collateral for these loans, there is rarely anything these creditors can do to hurt you in the short term.
8. Make loans with only household goods as collateral a low priority. Creditors rarely seize the goods due to their low market value and the difficulty in retrieval without involving the courts. If the creditors do start actions to repossess household items, you will be notified by letter.
9. Treat cosigned debts like any others. For example, if you put up your home or the car as collateral, that is a high-priority debt for you if other cosigners are not keeping the debt current. If you have put up no collateral, make the debts a low priority. If others have cosigned for you, you should let them know about your financial problems so that they can decide what to do about the debt.
10. Don't pay when you have a good legal reason to not pay. Examples include defective merchandise or the creditor is asking for money that it is not entitled to. If you believe you have a legal defense, contact a lawyer.
11. Don't move up a debt's priority based on threats to ruin your credit report. In most cases, the creditor has

already reported the delinquency to a credit bureau.

12. Don't move up a debt's priority because of debt collection efforts or threat of a lawsuit. Be polite to a collector, but make your own choices about which debts to pay based on what's best for you. Many threats are not carried out, and the procedure itself is long and complicated for the creditors. On the other hand, nonpayment of rent, mortgage, and car debts may result in immediate loss of your home or car.
13. Do move up court judgments in priority if the creditor has already sued. After a court judgment, that debt should move up in priority because the creditor can enforce that judgment by asking the court to seize your property, wages, and bank accounts.
14. Be cautious about consolidating debts or refinancing your home. Depending on your situation, this may or may not be the right option for you. It can be expensive and give creditors more opportunities to seize your important assets. A short-term fix can lead to long-term problems.

Government Debt

Income Taxes: If you cannot pay the total amount due, contact the Wisconsin Department of Revenue and the IRS right away. Ask for information on repayment plans and find out whether your reduced income makes you eligible for tax credits. Contact the Wisconsin DOR at (608) 266-7879 or www.dor.state.wi.us. There's a \$20 fee to make an installment agreement. Contact the IRS at (800) 829-1040 and ask to be transferred to "advanced accounts."

Property Taxes: Contact your county treasurer and explain your situation right away if you're not able to pay property taxes.

Child Support Orders: If your income has dropped sharply, contact your family court to find out about lowering your support order as soon as possible. This cannot be done retroactively.

Student Loans: If you are having trouble making your federal student loan payments, contact your loan servicer immediately. You may be able to have payments deferred – or postponed – during periods of unemployment or financial hardship. But you cannot qualify for a deferment once your student loan is in default.
