Family and Consumer Sciences

UNIVERSITY OF ARKANSAS
DIVISION OF AGRICULTURE
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FSHEC44

Financial Fitness Series

Trim Your Credit Line

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Is your stack of monthly bills overweight? Do you think your debts are too heavy? With patience and "stick-to-it-iveness" you can trim your outstanding bills and other debts. To do this you need to –

- give yourself a credit checkup.
- organize your credit payments.
- rank your debts in order to pay them off.
- decide when and when not to use credit.

Give Yourself a Credit Checkup

Most of us use credit. Credit allows you to use goods and services while you pay for them. But using too much credit can lead to problems.

Which of the statements in "Credit Checkup" apply to you and your family?

Credit Checkup

	Yes	No
1. You pay only the minimum amount due on your credit cards each month.		
2. You make so many credit purchases that the amount you owe does not shrink from one month to the next.		
3. You take out new loans to pay off old ones.		
4. You have to skip some payments.		
5. You overdraw your checking account.		
6. You charge day-to-day expenses like shampoo instead of paying cash.		
7. You receive past due bill notices.		
8. You rely on extra income from overtime to make ends meet.		
9. You use savings to pay current bills.		
10. Not counting your mortgage or rent, your credit payments are 20 percent or more of your take-home pay.		
11. You borrow money to pay expected expenses like insurance and taxes.		
12. You are late in making payments each month.		
13. Your emergency fund is less than $400.		
14. You put off medical and dental visits because you can't afford them.		
15. You are afraid that your utilities will be shut off or that something you own will be repossessed.		

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Worksheet Credit Payment Chart					
Purpose of Loan/Credit	**Source of Credit**	**Amount Still Owed**	**Months Left to Pay**	**APR***	**Monthly Payment**
Utilities					
Credit Card #1					
Credit Card #2					
Credit Card #3					
Installment Loan – Car					
Installment Loan – Other					
Store Charge Card					

*APR = annual percentage rate of loan **Total monthly payments** ___________________ (1)

Monthly income $___________________ divided by 5 (20% of your take-home pay) = ___________________ (2)

Trimming Tip #1

If you checked the “yes” column in the Credit Checkup Chart on page 1 for more than two or three of these statements, your credit could use some trimming.

Organize Your Credit Payments

Trimming Tip #2

The first step in trimming your credit is to figure out just how much you really owe.

You can organize your credit payments by using the Credit Payment Chart Worksheet (above). We’ve started you off. Other credit payments you might have to add to the list are educational loans, home improvement loans, checking account overdraft, personal loans for insurance, taxes, or travel, rent-to-own agreements and other installment purchases.

Trimming Tip #3

Credit payments should be no more than 20 percent of your take-home pay. If (1) in the Credit Payment Chart Worksheet (above) is greater than (2), you need to work hard at trimming your credit.

Rank Your Debts in Order

If you have more debt than you can handle, you need to decide which debts to pay and how to pay them. Line (2) on the Credit Payment Chart tells you the most you can safely afford to spend on credit payments.

But you may find that you can’t afford even this much. It all depends on your income and expenses. You can use “Financial Fitness Series: Shape Up Your Spending” to estimate your minimum monthly expenses. Any money beyond the bare necessities (food, shelter, heat, transportation to work) can be used to pay off debts.

Trimming Tip #4

Talk to your creditors. Explain your problem and how you intend to solve it. You can use the following methods to give you some ideas. Use the space under the explanation of each method to figure out whether it will work for you.

1. **Pro-Rate Method.** Pro-rate your credit payments. For example, if your income is $800 per month, you can safely afford to use $800 divided by 5 or $160 for paying debts. If your credit payments are $210 per month, you could divide the $160 (what you can afford) by $210 (what you owe) and pay about 75 percent on all your bills ($160 divided by $210 is 76 percent). If your car payment is $100, you would pay $75 (75 percent of $100 is $75). If your store charge payment is $75, you would pay $56 (75 percent of $75 is $56).

   Try to make your payments as large as you can. If you can afford to pay only $80 per month, you can still pro-rate your bills. Divide $80 by $210 (it equals 38 percent) and pay 38 percent on all your bills. You would pay $38 on your $100 car payment and $28 on your $75 store charge.

   To use the pro-rate method, you need to know how much you can afford and your total monthly credit payments:

   Total monthly income divided by 5. Use line (2) from the Credit Payment Chart or amount you can afford.

   ____________(a)

   Total monthly credit payments. Use line (1) from the Credit Payment Chart.

   ____________(b)

   Pro-rating = (a) divided by (b).

   ____________(c)

   Multiply monthly payments by (c) to figure how much to pay each creditor.

2. **Low Balance Method.** Pay off bills with the lowest balance due. For example, if you owe only two more payments on your car or refrigerator, you may want to hurry up and pay those off. Then the money you used for those payments can go to pay off other debts.

   Which debts do you have that could be paid off in two or three months?

   ____

   ____

   ____

3. **High Interest Method.** Pay off those debts with the highest interest rate. Interest charges can be very costly. Interest on some credit cards can be over 20 percent. Paying off those debts with the highest interest rates can free more of your money to pay on other loans.

   Which of your debts have the highest interest rates?

   ____

   ____

   ____

4. **Most Important Method.** Pay those debts which are most important to your credit rating or to keep your family safe. For example, you need to pay for rent, groceries and utilities in the winter. You may need to make a payment on the car to keep it from being repossessed. You may need to pay on a loan to prevent your wages from being garnisheed. Other debts may not be as important and can wait a while. If you owe on store and bank charge cards, you should try to make some payment on them each month because these businesses report monthly to a credit bureau and nonpayment will affect your credit rating.

   Which of your debts are most important?

   ____

   ____

   ____

5. **New Plan Method.** You could work with your creditors to set up a new payment plan for your debts. This idea works well with utility companies when you have high winter bills and lower summer bills.

   Which creditors do you think you could talk to about a new payment plan?

   ____

   ____

   ____

6. **Debt Consolidation.** You could get a loan to pay off all your debts. The payments on the consolidation loan would be less than your current monthly payments now because they are spread out over a longer period of time.

   Monthly payments will be lower; but in the end **it will cost more** because you will pay more interest. And if you cannot make several small payments, how do you expect to make one large payment? If you consolidate debts, you should stop using your credit cards and not take out any other loans.

When to Use Credit

Credit can be very helpful in emergencies. At these times, you may have no other choice but to use credit. But using too much credit can create problems. You and your family have to decide when to use credit and when to use some other alternative to get the things you want. For example, if you want to buy a $400 TV, you could do several things:

1. **You could rent it with an option to buy it.** If you rented the TV, you would pay about $13 per week (or about $56 per month) for about 78 weeks (18 months), making the total cost of the TV a bit <u>over $1,000</u>.

2. **You could buy it on credit.** If you bought it on credit with a 9 percent interest rate and 9 months to pay it back, your monthly payments would be about $23.84 or a total cost of $429.10.

3. **You could save up for it.** If you saved $13 per week (the same amount you would pay to rent), you could pay cash for the TV in 31 weeks, which is less than 8 months. If you and your family can wait and can make yourselves set aside the $13 a week, this is the lowest alternative cost, <u>$400</u>.

   That means your family has $29.10 or as much as $600 to spend on something else!

When shopping for the things you want, look for the best buy. Some stores offer low cash prices but charge high credit interest rates. Others have high prices but low interest rates. And others will be somewhere in between. Where you buy depends on whether you are paying cash or using credit.

Before buying on credit, ALWAYS ask yourself:

- Do I really need this item?
- Is there something else less expensive that would be just as good?
- Is this the best time to buy?
- Is there something else I want more?
- What other bills do I have to pay?
- Is the price reasonable?
- Have I compared credit rates to find the lowest cost?

Financial Fitness Series:
Shape Up Your Spending, FSHEC42
Build Your Savings, FSHEC43
Trim Your Credit Line, FSHEC44

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