

## Chapter 3: Paying Down Debt

### Seven Secrets to Paying Off Debt the Credit Card Companies Don't Want You to Know!

**OK! Let's talk about paying down some debt!**

Let's face it. No one likes or wants to be in debt. It's stressful, tends to bum one out, and gets in the way of building and achieving real financial goals.

The number one secret, of course, about debt is to avoid it in the first place.

“Spend less than you make and save the difference.” — Umm, yea, thanks for that, Mom.

We all know we should avoid building up debt, but with stagnant incomes, rising costs, and keeping up with the Joneses, the accumulation of some debt is a trap that catches most of us at one point or another.

The good news is that being in debt does not have to be a permanent condition, and there are several strategic ways to get out of debt if you're serious about taking control of your finances.

By the way, if you find yourself in this situation, the good news is that you're not alone. A recent study by the [Federal Reserve](#) Bank of New York shows that at \$12.96 trillion, overall household debt in the third quarter of 2017 is even higher than the previous peak of \$12.68 trillion in 2008 and is increasing rapidly. Credit cards, mortgages, student loans, and auto loans increased by 0.9%, or \$116 billion, from the second quarter of 2017, and are now 16.2% higher than the most recent low in 2013. The financial positions of many Americans, and we suspect of many people with disabilities, remain tenuous compared with their savings. According to a 2017 [Bankrate.com survey](#), 24% of Americans have more credit card debt than they have in a savings fund. In fact, only 52% of Americans have more emergency savings than credit card debt, the second-lowest percentage since Bankrate began tracking the issue in 2011. For people with disabilities receiving benefits through either SSI or Medicaid, asset limits (\$2,000 for individuals and \$3,000 for married couples) can only exacerbate this situation. According to the Federal Reserve, overall credit debt increased by \$24 billion in the third quarter of 2017, to \$1.023 trillion – a 5.5% increase in under one year. Despite these trends, banks are seemingly more comfortable with increasing credit lines. Total aggregate credit card limits have increased to \$3.49 trillion, the highest levels since the third quarter of 2009.

So, let's get to those seven secrets and see the best tricks and strategies to get out of debt.



#### **1. Never, Ever, Just Make the Minimum Payment.**

Owe a bunch of money on a credit card? Don't worry. You're not alone. And welcome to being human.

I like examples; they work better for me. So, let's say like the rest of us, maybe while in college, things like pizza, more beer than one likely remembers, and a mysterious number of Chicago Cubs tickets somehow got charged to one's credit card. Here you are much, much later in life with a \$2,000 balance and little hope of paying it off given your fixed income.

With a \$2,000 credit card balance, at a 21% interest rate, making only the minimum payment of \$40 per month means it will take 10 years to pay off your credit card, and you will pay \$2,795 in interest charges. Ouch, that's more paid in interest than I originally charged to the card!

And . . . the Cubs weren't even good that century, and it's going to take me 10 years to pay that back? Not only 10 years, but that \$20 ticket, after all that interest is paid back, will really end up costing me nearly \$47! The humanity!

OK, check this out; here's where the first secret of paying off debt can save you time, money, and start your march to financial freedom.

Let's say you were to increase your minimum payment to \$100 per month; you would pay off your \$2,000 balance in two years, paying only \$483 in interest charges and saving over \$2,300!!

Simply by always paying more than the minimum payment and stopping additional charges, you can pay down credit card debt quickly and efficiently.

There are many credit card calculators that can help you with figuring out your options. Check out Credit Karma's [credit card repayment calculator](#). We particularly like this tool, because it allows the user to model various repayment scenarios. Simply enter your credit card balance and annual percentage rate (APR) to determine how long it will take to pay off your debt, and then play around with accelerated payments and watch how quickly you can get out of debt. Be careful, however—many of the online calculators and websites are only industry fronts to push credit cards. Stick with trusted institutions when conducting research and analysis. Be sure to check out our [debt payoff tool](#).

But, umm, what if you, like most of us, have more than one debt?

Then, let me introduce you to secret number two.



## **2. Snowballing: A Multiple Debt Repayment Method, Championed by Personal Finance Guru Dave Ramsey, Which Is Based on Paying Off One's Smallest Debts First.**

Simply designate a certain amount of money to pay toward debts each month and pay the minimum payment on all debts except the one with the lowest balance. Then, target every other penny at the debt with the lowest balance, and when that debt is gone, do not change the monthly amount, but throw all you can at the debt with the next-lowest balance. Under this method, the extra amount paid toward the larger debts will grow quickly, similar to a snowball rolling downhill gathering more snow. This is a psychologically rewarding method, delivering small

debt repayment wins and, in theory, reinforcing the repayment behavior. In rather quick order, you can go from maybe five debts to four debts and then to three as you continue to allocate funds to the smallest remaining debt.

Here is a great [Wikipedia example](#) of how the debt snowball works:

“Let’s say you have four debts, two credit cards, a car loan, and a personal loan.

- Credit Card A - \$250 balance - \$25 per month minimum
- Credit Card B - \$500 balance - \$26 per month minimum
- Car Payment - \$2,500 balance - \$150 per month minimum
- Loan - \$5,000 balance - \$200 per month minimum

For the first two months under the debt-snowball method, payments would be made to the creditors as follows:

- Credit Card A - \$125 (\$25 per month minimum plus \$100 additional available)
- Credit Card B - \$26 per month minimum
- Car Payment - \$150 per month minimum
- Loan - \$200 per month minimum

For the third month balance (presuming you have not added to the balances, which would defeat the purpose of debt reduction), Credit Card A would have been paid in full and the remaining balances would be as follows:

- Credit Card B - \$448
- Car Payment - \$2,200
- Loan - \$4,600

Third month payments: You would then take the \$125 previously used to pay off Credit Card A and apply it as additional payment to the Credit Card B balance and make payments for the next three months as follows:

- Credit Card B - \$151 (\$26 per month minimum plus \$125 additional available)
- Car Payment - \$150 per month minimum
- Loan - \$200 per month minimum

Within three more months (six in total), Credit Card B would be paid in full (the final payment would be \$146), and the remaining balances would be as follows:

- Car Payment - \$1,750
- Loan - \$4,000

Then you would take the \$151 previously used to pay off Credit Cards A & B and apply it as additional payment to the car loan balance and make payments as follows:

- Car Payment - \$301 (\$150 per month minimum plus \$151 additional available)
- Loan - \$200 per month minimum

It would take you six months to pay off the car loan (the final payment being \$240), whereupon you would then make payments of \$501 per month toward the loan (which would have a \$2,800 balance) for six months (with the last payment being \$234).

So in 17 months, you would repay four loans, with two of them being paid in only five months and three within one year.”



### 3. Pay the Highest Interest Rate First.

The third secret to paying down debt is very similar to the snowball method, but we attack the debts with the highest interest rate first. So, again, simply designate a certain amount of money to pay toward debts each month and pay the minimum payment on all debts except the one with the highest interest rate. Then, target every other penny at the debt with the highest interest rate and when that debt is gone, do not change the monthly amount but throw all you can at the debt with the next-lowest interest rate.

Note: There is a vigorous spirited academic debate in the personal finance world about which method (snowball or highest interest rate) works better. There are some rigorous academic and economic studies that indicate each method works better than the other. So, recognizing that people are different, we suggest picking the method that works best for you and sticking with it! As Nike says: “Just do it!” And soon, probably faster than you think, you can be debt free!



### 4. Notify Lenders That Extra Payments Are to Go Directly Toward Principal Reduction of the Debt.

The fourth secret to paying off debt is a simple issue of notification. Some revolving debts, like student loans, mortgages, and car payments, will automatically apply additional payments to the next scheduled or monthly payment. This will only postpone your next due date but not accelerate the speed with which you pay down the debt. In order for the debt snowball or highest interest method to work, you must proactively notify the lenders to let them know that extra payments are to go directly toward principal reduction of the debt. Some lenders allow this instruction to be communicated over the phone or Internet, while others require written notification with every additional payment.



### 5. Snowflaking: Making Frequent, Small, One-Time Extra Payments Toward Your Debt.

Snowflaking is a fun debt elimination hack term where you make frequent, small, one-time extra payments toward your

debt. It can work independently or as a sort of turbo charge to either the snowball or highest interest rate methods. “Snowflakes” are normally little things like paying an extra \$6 towards your debt instead of eating out for lunch one day, drinking the office coffee rather than the daily latte, or quitting smoking and saving six to eight bucks a day.

Remember, any little thing that you can do to save a little at a time can be applied to paying your debt a little at a time. But snowflaking doesn’t have to stop there. Any extra income from a one-time job, survey, babysitting, rebates, coupons, birthday gifts, recycling, or eBay or garage sale can be used to pay off that debt. We even met a guy who rounds down his checking account balance to the nearest \$50 and directs those dollars every Friday before leaving work to the principal on his mortgage.



## 6. Use Windfalls Wisely.

Received a surprise financial birthday gift? An unexpected bonus or a reimbursement check you forgot about? Maybe you had a larger than expected tax return? Consider using a part of any windfall as a way to pay off more debt. Many experts suggest using 1/3 of any windfall to treat yourself, 1/3 for savings, and 1/3 to pay down any debt. This way, you can have

some fun, build some savings, and continue your mission to get out of debt. The IRS makes splitting a tax refund really easy. Just use [Form 8888](#) to directly deposit your refund (or part of it) to one or more accounts at a bank or other financial institution (such as a mutual fund, brokerage firm, or credit union) in the U.S. This form can also be used to buy up to \$5,000 in paper Series I savings bonds with your refund.

Remember, too, that people with disabilities, even if they have no filing requirement for tax purposes, may still be eligible for the Earned Income or Child Tax Credit (EITC and CTC). These credits are retroactive for up to three years and can put real money into your pocket. Check out our friends at the National Disability Institute’s [Real Economic Impact Network](#) for more about free tax preparation for people with disabilities.

As an example, if you have a 15% interest rate, using a \$2,000 tax refund to pay down credit card debt not only gets you closer to a debt-free balance sheet, but it also saves you \$300 per year in interest. That’s a reward you can’t afford to pass up.



## 7. Ask for a Reduction in Your Interest Rate.

That’s the lucky seven debt reduction strategy the credit card companies don’t want you to know. Asking the credit card company for a reduction in your interest rate is, perhaps, the easiest strategy to paying off. It works! Not many people know you can even do this, but if you have been making your monthly payments in a timely manner, and you have been a customer for more than a year, give it a try. Mentioning to the

service agent that you have a good payment history and have been a good customer should be part of your strategy.

You could also mention that you have a balance transfer offer at a significantly lower interest rate from a different company, but would like to stay with your current company if they could match it. If you have good credit, you could also shop around for a good balance transfer offer. Check out [Bankcard.com](http://Bankcard.com) for the best credit card offers around. If you use a service like [CreditKarma.com](http://CreditKarma.com), they can provide info on cards matched to your credit score.

OK, so there are seven ways to reduce and pay off your debt. Pick one... dang, pick three and get to work building a new financial future. Which one do you like best? Which one seems easiest to implement?



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