Education First
FEDERAL CREDIT UNION

THE ULTIMATE GUIDE TO DEBT CONSOLIDATION

Are you struggling with debt? If so, you aren't alone. American household debt hit a record $16.9 trillion at the end of 2022, up $2.75 trillion since 2019.

When you owe a lot of debt, getting out of it can seem impossible. Debt can be complicated, but luckily there is a lot you can do to change your financial situation. One avenue of getting out of debt would be debt consolidation.

This eBook covers common causes of debt, who would benefit the most from debt consolidation, and tips that can teach you how to get out of debt for good.

Common Causes of Debt

Have you ever wondered how people get into debt? Most people immediately chalk it up to bad spending habits or poor financial planning. There's no doubt that money management and financial planning play a role in debt, but that's not the whole story.

If you or someone you're close to is struggling with debt, don't just assume that it all comes down to how you spend and plan. Here are some of the most common reasons people fall into debt.

Reduced Income

Maybe after years of being a two-income household, you're now down to one principal earner. Changes at work may have resulted in a pay cut or a change to your bonus structure. You may be working fewer hours or could have lost a freelance client.

A reduction in income is one of the leading reasons why people fall into debt. Sometimes even losing as little as one hundred dollars per month could cause financial disaster for some individuals and families.

Underemployment

Almost everyone has been without a job at some time or another and knows how difficult it can be to get by. But have you thought about what it's like to work a job that can't – or sometimes won't - pay you enough money?

Underemployment became a huge issue in 2020. During the start of the pandemic, companies reduced hours, instituted pay cuts, put people on furloughs, and some jobs were eliminated entirely. Even with the economy starting to recover, not all companies have returned to normal operations with the same level of staff. Many people who didn't lose their jobs could still be dealing with reduced salaries, benefits, hours, and more.

It's important to keep in mind that underemployment can still cause problems even if it's a temporary situation. People may be forced to take out extra credit cards or loans to keep up with their existing bills in the meantime. Eventually all of this can add up, and people can find themselves in worse debt once they do finally find a job that can make ends meet or if their company returns to normal.

Divorce

Most people don't expect divorce to be a simple or inexpensive process. Aside from court and attorney fees, divorcing a spouse can have a big impact on financial stability.

No matter the age, divorce can have a major impact on one's financial outlook. If they are over the age of 50, it could cause major problems with retirement or other plans. Younger couples that get divorced often have a hard time financially as well because alimony and child support come into play if there are children.

Some people may have to quickly enter the workforce after years or decades of not holding a job. Others could have to pick up extra shifts or side gigs just to make ends meet. All these problems can cause a lot of long-lasting debt.

Medical Expenses

A lot can be said about the state of health care in our country. The United States has arguably some of the best healthcare in the world, but it often comes with a hefty price tag.

Medical debt may not show up on your credit report, but it can still wreak havoc on your finances.

It's also important to note that people have resorted to taking out loans and credit cards just to get the healthcare they need. Those costs can add up very quickly and people can continue to struggle to pay down that debt for years after a medical event.

Lack of Savings

Some people focus on their savings to go on a nice vacation or make a large purchase. However, many people forget about having an "emergency fund." An emergency fund is money that is set aside strictly for emergencies. Emergency funds should typically have three to six months' worth of expenses.

Would you have the money if your car needed expensive repairs? Could you handle paying for a stay in the emergency room? Do you have money set aside to pay a lawyer if you or a family member found yourself in legal trouble?

You never know when you might need money for an emergency, and people that don't have adequate savings can easily go into debt trying to handle one big problem.

Are My Spending Habits Making Debt Worse?

You read the above section, but you don't feel like any of that applies to you? You're not divorced, you don't have medical expenses, you're gainfully employed, and you even have an emergency fund/savings account. Despite all of that, you still find yourself struggling with debt.

It's still possible to do everything right on paper but continue to make mistakes when it comes to spending habits. If you think you're doing everything but are still stumped about why you're in debt, see if any of these common behaviors could be affecting you.

You Make Impulse Purchases

An impulse buy is something we spend money on that we really weren't planning to – and likely don't need. Monthly bills and expected expenses are not impulsive buys, and neither are things you've carefully saved and planned for. However, a last-minute happy hour or a new handbag could be considered an "impulse purchase."

There's nothing wrong with deciding to buy a cup of coffee on a whim or to even splurge on an item you've been eyeing for weeks.

The problem occurs when you can't seem to stop yourself from buying those unpanned items and it happens often.

Did you know that the average American can spend over $5,000 a year on impulse purchases? You may think that you're making a spontaneous purchase every now and then, but that behavior can be difficult to break once it becomes normalized.

You Don't Have a Budget (Or Don't Stick To It)

Some people assume that they're doing well financially if they always have enough money to pay their bills. However, if you're living without a budget, you could easily put yourself in a situation where you don't have enough money to keep up with your bills because of other expenses.

People don't make budgets to pay bills or keep up with regular expenses. Budgets are for helping people reach big financial goals and to keep debt under control.

Remember, budgeting isn't just something that you do once and forget. Your budget should be updated often and should always be reassessed if your income changes or if you need to cover other costs.

Making a budget is one thing, but sticking to it is an entirely different matter. If you've made budget plans in the past but failed to stick to them, it doesn't mean that you aren't a budget person. It could just mean that you need the right tools to help you budget effectively. There are plenty of apps available for those that need a way to budget that is right at their fingertips.

You Live Above Your Means

When people think about living beyond their means, they usually think of someone that has very little money but keeps spending what they have on things they can't afford. While this can be true, you should know that anyone can live beyond their means on any income level. You may be living beyond your means if you can say any of these statements:

- I run out of money a lot before payday.
- I don't make contributing to my savings account or emergency fund a priority.
- I must pay for a lot of things on my credit cards.
- I haven't made any progress paying off my debt in a year.

The Psychological Downside to Debt

Some people can pay off their debt easily once they figure out a solid plan. Others may struggle with debt throughout their lives. There may even be a few that spend most of their lives building up more and more debt.

Getting out of debt can be difficult for a variety of reasons, and not all of them have to do with money. Debt can have a profound effect on people's mental health. The holders of the debt can become anxious or even depressed about their financial situation. In some cases, it's possible for spouses – even children - to develop anxiety over money.

The sometimes-overwhelming sense of worry and dread can make it difficult to focus on anything else. Some people may even feel like their situation is hopeless and impossible to get out of debt. By having a solid plan, it is possible to get out of debt.

So let's talk about some practical ways to eliminate debt, from debt consolidation to good financial planning.

What is Debt Consolidation?

Simply put, debt consolidation is a debt management method that allows people to reduce what they owe by rolling multiple debts into a single payment through a credit card or a personal loan.

Although debt consolidation can be used for virtually any form of debt you may have, it's most effective for people with high-interest debt.

When people struggle to pay off their debt, the issue frequently has little to do with making payments on time; they're able to make monthly payments with ease, but they can only pay the minimum. This may help them avoid late penalties, but could damage their credit score, and won't help them make any progress toward getting out of debt since the interest continues to snowball.

That is why debt consolidation is such an effective way to manage debt – it takes multiple payments with multiple high interest rates and puts them all in one bucket. Only one payment is required, typically with a much more reasonable interest rate.

You could get an idea of what this payment would look like by using a debt consolidation calculator.

Who is Debt Consolidation For?

Debt consolidation can be effective for almost anyone that has outstanding debt to eliminate, however there are some people for whom a consolidation strategy would work *best*.

Before we dive into the best candidates for debt consolidation, we have a quick task for you.

1. Write down all your unsecured consumer debts. This would include credit card balances, medical debt, and personal loans.
2. Compare your total debt amount with your gross annual income.

3. Figure up the math on how long it would take to pay off your debt with the same payment schedule that you have been using. This would include how often a payment is made and the amount.
4. Think about the interest you'll likely pay and what other bills you need to prioritize.

Now that you have an idea on where you are with your personal debt, we can examine who debt consolidation can help the most.

Your Debt Isn't More Than 50% of Your Income

It's important to keep in mind that debt consolidation strategies center around being able to make payments on one loan or credit card. That's why it works best for people that have some form of income they can devote to making regular payments.

If your debt is already 50% or more of your income, making payments on a larger loan or credit card may be too much to handle. People who find that they have a lot more debt than income should consider other financial alternatives to get their debt under control. Consider speaking to a financial advisor about the best next steps to take.

Your Credit Score Is High Enough to Qualify for Low- Interest Credit Cards and Loans

Most consolidation strategies won't be able to work unless you're able to secure a low interest credit card or a very low-interest loan. If you have an extremely low credit score, consolidation may not be the best option for you.

Don't worry - you don't need a spotless record to have the right credit score. Some people say that having a score in the mid- 600s is enough for a loan. You may be able to find lenders that are even willing to go lower.

You Don't Have Trouble Making Consistent Payments

People can fall into snowballing debt for a variety of reasons. Some people may be unable to make their monthly payments and keep falling behind. Others may not have an issue making monthly payments, but they struggle to keep up with interest.

If your main issue is chipping away at debt because of high interest, debt consolidation may be the best strategy for you. Since consolidation cards and loans have low rates and are meant to focus on the debt itself, you won't have an issue making your regular payments to stay on top of things.

People that can add a little extra to their monthly payment are also excellent candidates for consolidation. If you're able to slowly chip away a debt with an extra couple of dollars a month, you can make even better progress toward paying off debt without having to worry about high interest rates.

You Have a Plan to Stay Out of Debt

Debt consolidation plans can be very helpful, but they aren't magic. A good consolidation strategy can absolutely help you get your current debt under control, but it won't help you in the future if you continue to build up more debt.

Figuring out ways to stay out of debt isn't as simple as vowing not to take out any more loans or credit cards. Finding ways to save money and bring in more income can be far more helpful when you're thinking about ways to ensure you stay out of debt.

Debt Consolidation Loans vs Credit Cards: What's Best?

If you're interested in debt consolidation, your main methods are going to be loans or credit cards. The method that's right for you is going to be a matter of personal preference, but there are some unique benefits to loans we should address.

Credit cards that are made for debt consolidation normally lure people in with a 0% interest rate on balance transfers and quick application times. These may be good features in the short term, but the long term can bring its own unique issues.

The 0% interest rates you were promised will always come with an end date. It's also important to note that interest rates are always subject to change and could even get worse as time goes on. A debt consolidation loan tends to be the better option because you don't have to worry about changing interest rates. What you agree to in the beginning is what you'll pay throughout the life of your loan.

Another benefit is that these loans are designed with an end date in mind. The best personal loans for debt consolidation come with a fixed term, so if you make your payments on time, there will be an end in sight for your debt.

Snowball Vs. Avalanche: Using Pay-Off Strategies With Debt Consolidation

Once you figure out what debt consolidation method you are going to follow, it will be time to think about payoff strategies.

The most popular payoff strategy people use is the snowball method or the avalanche method.

The snowball method is when you continue making minimum payments on all your debts and pay more money towards your smallest debt. Once that debt is paid off, you move on to the next smallest debt and continue to do the same.

When you use the avalanche method, it involves making minimum payments on all your debt, while paying more towards your “highest interest debt.” Once that debt is paid off, you move on to the next highest interest debt and begin making higher payments until that debt is paid off. You continue this cycle until all your debts are paid off.

Both methods have their own unique benefits. The avalanche method can sometimes give you lower payments over time. The snowball method can be a great way for people to devote enough time and energy to pay off large debts.

Like with loans or credit cards, your personal preference will be what matters the most when you choose. Either way, we highly recommend using one of these strategies along with debt consolidation to pay off your debt fast.

Tips For Staying Out of Debt

Debt consolidation is a great way to start the process of getting yourself out of debt. However, as we said earlier, a full plan is necessary if you want to ensure that you stay out of debt for good. Think of debt consolidation as the first step in your debt-free life plan. Now is the time to start making changes to your mindset and lifestyle to help keep you debt free.

Make a Budget

We've talked about the importance of creating and sticking to a budget earlier. Budgets are crucial for staying out of debt, and luckily, it's very easy to make one you can follow.

Start off by gathering all your financial information. Find your W-2s, bills, bank statements, 1099s, and all documentation you could use to get a full picture of your financial situation.

Once you've done that, make a comprehensive list of your monthly expenses. Don't just think about reoccurring bills and groceries. Think about how much you spend when you go out with friends or your spouse. Take note of how many impulse purchases you've made over the past few months and set aside money for unexpected expenses.

After you have everything laid out, it gets a lot easier to see what expenses matter the most to you and what you need to devote money to. Do you want to go a little more in-depth? Feel free to use any of Education First FCU's Financial Calculators so you can get precise amounts for your budget.

If you would like to have a budget directly at your fingertips at any given time, try one of these apps. If you are an EFFCU member, use iThrive to track your spending and budget.

Adopt a Frugal Mindset

You may not think that you live extravagantly, but it's important to be as frugal as possible when you want to pay off your debt. Now is the time to cut back wherever you can, even if you only start off by saving a few dollars here and there.

You may not go out to eat often, but you could cut down on fast food and takeout. Instead of having a full cable package, consider cutting down to basic or just relying on some of your streaming services.

Are you having trouble trying to figure out where to cut down on your spending? Look at your budget and see where you can move around funds.

Once your debt is settled, you can figure out what you can add back into your budget, but you should still spend less money than before. Think about ways you can save and treat yourself, but don't think about "going back to normal." Remember, the normal you had before caused the debt problems you're having now.

Stop Making More Debt

This may seem like an obvious thing to do, but it's often much easier said than done. It's important to do whatever you can to ensure that you don't just pay off the debt you have, but to develop healthier habits that prevent you from getting into debt again.

If you must cut up your credit cards, feel free to use a shredder to make everything easier and more secure. Even though you may feel a little dip in your credit score, don't be afraid to completely close your accounts if it'll keep you from building up debt again.

Some people may even consider freezing their credit to make sure they don't make their financial situation any worse. Nothing is too extreme if you want to ensure that you stay out of debt for good.

Build Your Emergency Fund

All you need is one bad day or an unexpected problem to pop up that can you put you right back into debt. Lessen your chances of having to rely on a credit card or loan when an emergency happens and spend time building up an emergency fund now.

Put some space in your budget for building your emergency fund. Make building it up just as much of a priority as paying off your debt.

Having extra money around will come in handy in case of an emergency. Instead of having to borrow money or take out a new line of credit, you'll be able to face whatever comes your way.

Talk to a Financial Planner

Do you have trouble coming up with budgets and savings plans? Are you a little embarrassed about some of your bad money habits? Do you struggle to think about what steps you should take to build a good financial future?

Don't live in the dark anymore. If you want to stay out of debt, and secure your financial future, spend some time talking to a financial planner now.

A financial planner can help you pay off your debt, build up your savings, prepare for retirement, and generally make the best choices with your money. If you've had trouble getting your finances in order in the past, it's worth getting the help of a financial expert now.

If you aren't ready to talk to a financial planner yet, devote some of your free time to improving your financial literacy.

Aim for Full Transparency

Some people may not see anything wrong with hiding a receipt or a bill or two, but when you lie about finances to partners, spouses, or even parents, you aren't doing anything to help your situation.

Honesty is always the best policy in any relationship. Keeping purchases and other financial information a secret can be stressful. It also keeps people in the dark about important things that could affect their future.

Instead of trying to hide your financial behavior, bring it front and center. Have frank and honest discussions with the people closest to you about what you're doing to pay down your debt and the financial decisions you've been making.

If you're married and have been keeping your accounts separate, now may be a good time to give your partner insight into how you've been spending. Keeping them in the know can help keep you on the straight and narrow.

Set Up Monitoring Services

You may be devoted to keeping down your debt and improving your credit score, but there are plenty of criminals that don't have the same mindset. When you're working on repairing your credit and paying down your debt, spend a little time setting up some precautions to make sure other people can't undo your hard work.

Anyone that gets a hold of your personal information could open credit cards, take out loans, and do a lot to harm you financially. Set up credit monitoring services now to make sure that you can keep your most important information safe.

Find True Debt Relief

As you can see, debt can be a tricky thing to manage. When there are so many personal, financial, and even psychological factors to take into consideration, true debt management can seem impossible. Luckily, debt consolidation and a solid strategy can make it easy for you to finally get out of debt.

Do you have any questions about what we've discussed in this post? Regardless of what you need, we're always happy to help. Be sure to reach out to us today so we can talk about the best way to consolidate your debt.

19 REASONS to Create and Stick to a BUDGET

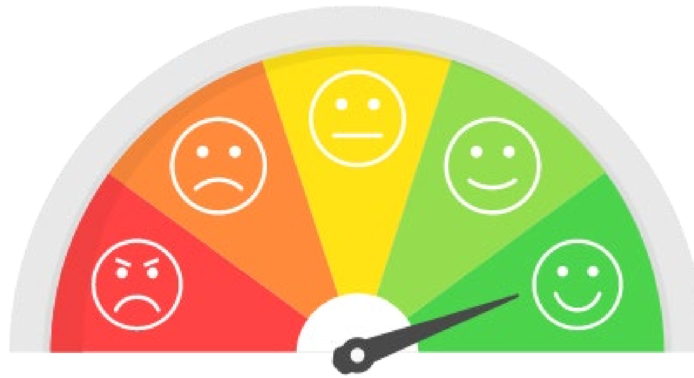
1. You'll spend **less.**
2. **You'll argue less about discretionary spending.**
3. You'll have money for fluctuating expenses.
4. You'll always have enough for fixed expenses.
5. **You'll save more.**
6. You'll feel more **in control** of your finances.
7. You'll be motivated to increase your earning potential.
8. You'll feel less guilt about impulse purchases that are **within your budget.**
9. **You'll feel more responsible.**
10. You'll never miss a bill payment.
11. **You'll set a better example for your kids.**
12. You'll spend less on groceries.
13. You'll **invest** more.
14. **Your stress levels will decrease.**
15. **You'll be able to make quicker decisions.**
16. You'll be prepared for financial changes.
17. You'll find yourself choosing healthy meals and snacks.
18. You'll be protected from debt.
19. You'll see potential money problems before they happen.

Check out these additional resources

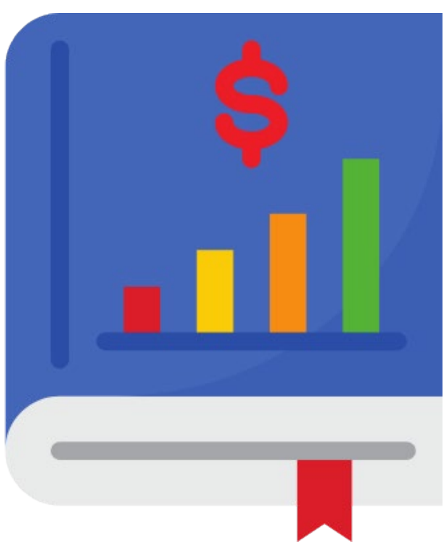
Want to learn more? Check out these valuable resources below!

Financial Calculators

Smart Score



Financial Education



Debt Consolidation Loan