

Credit Problems

Making Minimum Payments

Making minimum payments when repaying credit is designed to generate the most amount of interest. Though making minimum payments allows a user to avoid late fees and keeps the account in good standing, the effects of only paying the minimum are long-lasting. These include: taking a much longer time to pay off debt, paying more in interest and hurting credit scores if carrying high balances.

A real life example:

If Ariel has credit card debt of \$6,000, at an interest rate of 15 percent, and pays only the minimum payment, she will be paying on the debt for 169 months and pay approximately \$4,060 of interest. If she doubles her minimum payment, she will pay back the debt in 65 months and only pay approximately \$1,500 in interest. If Ariel pays \$100 in addition to her minimum payments, she would pay off the debt in 41 months and only pay about \$1,400 in interest.

How to solve:

Experts have found the best method for repaying debt is to pay off at least \$100 over the minimum payment. When dealing with multiple lines of credit (for example, a credit card, a student loan and a car payment) experts recommend using the snowball method. The smallest debt would be paid with a \$100 extra each month, then once that debt is paid off the entirety, the monthly payments would be used to continue to pay off the next line of credit.

Using Credit for Emergencies

When emergencies occur (medical problems, unexpected house repairs or loss of income) they may bring large expenses. Sometimes the only option people have is to put these expenses onto a credit card. Credit cards are best utilized for purchases which can be paid off quickly. Putting large purchases on a credit card may result in having to pay large amounts of interest and can affect credit scores by utilizing a high percentage of available credit.

A real life example:

Jack broke his arm in a skiing accident which resulted in medical expenses of \$3,000. He put the expense on his credit card. The card had an interest rate of 15 percent and when he finally paid off the balance three years later, he had to pay \$744 of interest.

How to solve:

If Jack had set aside emergency funds, he would have been much better off when handling this emergency expense. Even if he only had \$1,000 of emergency funds saved and put the rest of the bill on a credit card, he would have paid off the balance in 23 months with only \$302 interest, assuming he was able to make the same payments. Additionally, he could have asked the hospital for a payment plan,

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because these are often interest-free. Though emergencies can be stressful, research various payment options before charging large expenses to a credit card.

Paying Less Than The Minimum Payment

Occasionally, events happen which prevent the ability to pay the minimum payment. While some people may think paying some of the minimum payment may be better than paying nothing, paying less than the minimum will result in late fees and can impact a credit score. Lenders may also increase interest rates if payments continue to be missed. Some lenders may not apply payments less than the minimum payment and will hold payments in escrow until obtaining the full payment.

A real life example:

Jenny lost her job and cannot afford to make full payments to her student loans. She has interviews and her prospects for having a new job within the next few months are high. She is unsure on how to proceed with making payments.

How to solve:

First, Jenny should try to cut back as much of her unnecessary spending to attempt to pay the minimum payments for her loan. She should also continue to send in as much of the payment as possible, this shows the lender she is still dedicated to making payments. Many lenders will also be willing to work with someone who is temporarily experiencing a difficult time, if she reaches out to explain the situation. By explaining she is cutting back on expenses to afford the payments, actively seeking a new job and continuing to pay what she can, lenders may be willing to waive late fees or allow her to defer payments for a short time.

Acquiring Too Much Debt

When acquiring any kind of debt, planning for a realistic future is important. This means considering realistic expectations for future income and being thoughtful about what repayment will actually look like for any debt. Most experts agree all debt repayment should not exceed more than 36 percent of income, this includes car payments, mortgage, loan payments and any credit card payments.

A real life example:

When Tanya entered college, she wanted to major in theater. Rather than taking a full scholarship offered by a small college in her hometown, she decided to go to a university in New York City for the possible exposure and opportunities available. She has accrued more than \$200,000 in student debt. She now works in New York City as a waitress and volunteers for a small theater production house. She struggles to make the \$950 monthly student loan payments and afford other living expenses when she takes home \$2,300 each month.

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How to solve:

When Tanya took on her student debt, she did not consider what salaries commonly look like after school in her profession. While she may be able to increase her income down the road, her current loan situation will seriously impact her ability to meet other financial goals and may even affect her ability to pursue the career she wants by requiring her to move to a more affordable city or obtain a more stable job. Ideally, she would have taken the more affordable college option given the unreliable nature of theater careers. This would have allowed her to start her career debt-free and allowed her more flexibility to determine how to best pursue her dream job. However, since she did choose to take on student loans, she should be working to increase her income in order to have a more sustainable debt percentage.