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Debt consolidation and credit counseling

Even in a rough economy, paying off what you owe is vital

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Fixing the problem

Consolidation

Debt consolidation simply means you take a loan for the amount of all your other debt (generally excluding mortgages) and you make one payment to that loan instead of paying all your creditors separately. The monthly payment is fixed, which makes it easier to plan for in your budget.

"On paper, these are great, but in real life, they only work for the very disciplined consumer," Cunningham says.

History shows consumers tend to run up the bills again. In a year, they not only have their bill consolidation loan payment, but they've run up their credit cards again, adding even more to their monthly obligations, she says.

For homeowners, another way to consolidate debt is with a home-equity loan or a mortgage refinance. In this case, you would borrow the amount you owe to other creditors against the value of your home.

If you still have equity, know the advantages and disadvantages.

"You get a tax-deductible interest rate that is generally lower than credit cards and unsecured lines of credit," Lynch says. "Second, you get a longer payback period, which reduces the monthly payment as well."

O'Connor agrees with the advantages, but he says there are significant risks to this strategy.

"It must be carefully considered, because you don't want to create a bigger crisis by risking the loss of your home," he says.

If you're not willing to risk your home, moving high-interest balances to cards with zero-percent or low interest rates may work for you. But Lynch says it's a bandage with a very short-term solution.

"The rates have a tendency to rise fast," Lynch says, and consumers need to keep a close eye on the expiration dates of those favorable rates.

Your options

Credit counseling can come in many varieties, and just about anyone can claim to be a credit counselor. Unfortunately, not all services are equal, and too many people are out there to make a buck on consumers in a state of financial panic.

Depending on the severity of your debt, you may need different kinds of services. You should go to a counselor who offers a variety of services, such as budget counseling, debt counseling, housing counseling and bankruptcy counseling.

Those who are starting to feel the pinch may only require simple counseling, where a pro will help you establish a budget, manage your money and come up with a plan to pay off your creditors without any wheeling or dealing.

If you're not able to meet your monthly obligations, you may need a debt-management plan.

"With a DMP, the counselor negotiates with the creditor for a lower interest rate, lower monthly payment and to have late fees and over-limit fees either stopped or lowered," Cunningham says.

With a DMP, you would make payments to the counseling service, which then will send payments to your creditors. Most plans take between 30 and 60 months to complete, and by the end of the plan, you will have paid 100 percent of your debt.

Cunningham says that may seem like a long time, but if the consumer owes \$9,000 in credit-card debt (often cited as the average amount) at an APR of 18 percent and only pays the minimum amount due each month, even if he never adds any new charges, it will take him 47 years to become debt free. Even worse, he will have paid \$23,994 in interest. The terms of a plan will mean far less interest and a much faster payback time.

Fees for debt-management plans vary, but reasonable set-up fees are in the \$50 range, and monthly servicing fees run about \$25, according to the NFCC.

Another option is to try and erase some of your debt through debt settlement. A credit counselor will negotiate with your creditors with the goal of having some of your debt forgiven. But this, like bankruptcy, leaves a stain on your credit report. It's an extreme option, and should be considered a last resort.

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In today's economy, it's no secret people are having trouble keeping up with their bills.

Consumers often turn to credit cards for short-term relief, but as balances grow and monthly obligations rise, it's time to look for a way to stop the bleeding, permanently.

"First, do a budget to determine what comes in, versus what goes out," says Jerry Lynch, a certified financial planner with JFL Consulting in Fairfield.

"Second, what expenses can be reduced or eliminated? And does that balance the budget? If that doesn't work and you are still running out of money, consider a counselor — the sooner, the better."

Here's what you need to know to consolidate your debt the smart way.

THE EXPERTS

Gail Cunningham, spokeswoman, National Foundation for Credit Counseling, Silver Spring, Md.

Jerry Lynch, certified financial planner, JFL Consulting, Fairfield

Brendan O'Connor, certified financial planner and public accountant, Lincoln Financial Advisors, Edison



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All about you

Doing it yourself

You can take many of the same steps a credit counselor would perform and negotiate with your creditors. But you must be disciplined and keep your emotions out of the equation.

Start by calling each of your creditors. If you've come into a temporary tight financial spot, such as a temporary layoff or disability, explain what's happening before the collection agencies start to call. Tell your creditors you want to make good on your debt, but you would like some help from them. You can ask for lower interest rates, sometimes even stopping interest charges altogether. Request a cessation of certain kinds of fees, such as over-the-limit fees, and you can even create a set payment plan for lower monthly payments.

"That's a good idea, particularly if the problem is short-term," Cunningham says. "Most creditors have in-house help programs that provide assistance for three to six months."

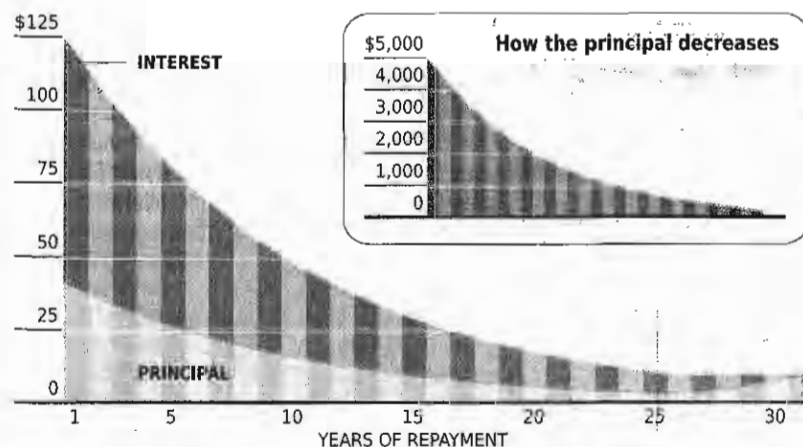
If the creditor says no, be persistent and ask to speak to a manager. You've got nothing to lose by asking.

Your credit report

Having late payments and skipping payments are among the worst things you can do for your credit report. Don't avoid credit counseling because you're afraid it will hurt your report.

"Being with a credit counseling agency

Principal vs. interest payments



has no bearing on the credit score," Cunningham says.

But if you can't pay your bills, that also will show up on your credit report eventually.

Don't create new debt

If you're getting out of a hole, you have to be especially vigilant about future spending.

"Changing ingrained behavior patterns is the hardest thing we do," Cunningham says.

To prevent re-debting, O'Connor suggests: **1.** Create a budget. "A budget doesn't have to be about depriving yourself," he

says. "It's about seeing how you're spending your money and to help you decide whether you should cut back."

2. Pay off credit cards monthly (or as soon as possible). Credit-card debt is not only very expensive, but the interest is not tax deductible, he says.

3. Create an emergency fund. One important goal you should add to your list is to build up an emergency fund with enough money to cover three to six months' worth of expenses.

Finding a reputable firm

The NFCC has guidelines and questions you should ask credit counseling firms before you sign on at DebtAdvice.org.