When Your Income Drops: Fact Sheet 6

Plan to Pay Creditors and Protect Family Welfare

Many circumstances can lead to a loss or drop in income, and you may be caught unprepared, with a seemingly endless list of bills to be paid. When this happens, you want to protect your family’s welfare, but you will also have to deal with your creditors. It’s important that you not leave the decision-making to others, or to chance. Pretending you have no money problems won’t make the problems go away. You and your family must face the situation honestly. Openly discuss the situation with all family members. This will help everyone realize that changes and sacrifices must be made, at least for the immediate future.

You will want to contact your creditors. Don’t wait for them to contact you. Your past experiences with creditors are important. If you have consistently paid bills when due, your creditors will be more cooperative than if you were frequently late or didn’t make regular payments. Creditors are in the business of lending money and/or providing services. They want to keep your business, but they also want to get paid. Most creditors will work with you to adjust your payments because they would rather receive smaller payments on a regular basis than begin expensive collection proceedings.

Sizing up your situation

Before you talk to your creditors you need to determine how much money you owe and how much money you have to pay your bills. Figure out how much income you can count on each month and how much you need to pay for your essential monthly living expenses. How many creditors do you owe and what is the total amount you owe? How long is your present financial situation likely to last? What assets (savings, items that could be sold) do you have that could be used to pay off your debt? What debts are the most important to pay first? Will vital service be cut off if you don’t pay?

Who gets paid first?

You are legally obligated to pay all of your creditors. If you can’t pay all your bills, you need to decide how much to pay and to which creditors. One way is to divide all the available money and pay every creditor a share of what you owe. This is probably the fairest way, but it doesn’t always work because each creditor must agree to reduce the amount they receive and extend the payment period.

A second method is to determine which creditors receive the most money. Think about the worst consequences for your family if certain debts aren’t paid or if less were paid than the amount due. What will affect your family’s health and security the most? Usually rent or mortgage payment, utilities, food, transportation, and medical insurance take priority. Don’t be tempted to let medical
insurance slide when money is tight. If anyone in
your family becomes ill, uninsured medical costs
could be devastating.

You can lose your possessions if the creditor
holds the title to the property as security for the
loan. Sometimes furniture and large appliance
loans are secured loans. If you aren’t sure which
loans are secured, check the credit contract.
Unsecured debts may have to take lower priority
temporarily, although you are obligated to pay
them, too.

Determine how much you have paid on
each loan or contract and how much
you owe. If you have only one or two
payments to make on a loan, it’s
probably a good idea to finish paying it,
getting that debt out of the way. You may
be able to return newer items or sell
them to pay off the debt. If you choose
to voluntarily surrender the item, you’ll
still be required to pay the difference
between the market value of the item
and the amount remaining on the loan.

But getting out from under some of your
debts can reduce the pressure you feel.

Credit card firms charging 1.5 percent
interest per month would receive 18 percent
interest per year on the unpaid balances. If you
have a loan with a lower interest rate, you may
decide to pay off the higher-interest credit card
balance first, to reduce the amount of finance
charges you are paying. “Power Pay” is a
computer program that can assist you in
determining different options and the costs
associated with each option. It is available at no
cost at https://powerpay.org. Until your financial
situation improves, destroying your credit cards
and closing your accounts may be a good idea.
At least put the credit cards in a safe place so
you are not tempted to use them.

You can lose your possessions if the creditor
holds the title to the property as security for the
loan.

Deciding which bills to pay first

Which debt should be repaid first? If you don’t
have enough money to go around, debts should
be paid back based on what will happen if you
don’t pay your bills. Ask yourself these questions.

• What is the “secured” status of the loan? If
the loan was co-signed or secured by
collateral, pay this back first. If you don’t, you
may lose your property. Secured loans are
made by pledging personal assets or by
co-signing with another person. Unsecured
loans are loans you get on the basis of your
signature and good credit rating.

• What legal action has been taken? If you do
not want your wages garnisheed or the item
repossessed, pay the debt back as soon as
possible.

• How much interest are you paying? How
much money are you paying to borrow the
money? Debts with the highest interest rate
are costing you the most.

• What will happen to you if you don’t pay the
bill on time?
  a. Is there a “grace period” for paying
     before the creditor takes action to
     collect?
  b. Is there a penalty or charge for late
     payment?
  c. Will the remaining balance need to be
     paid in full if you miss a payment?
  d. Will the creditor harass you?
  e. Will you lose your possessions or assets?
  f. Will your utilities be disconnected or will
     you be evicted?

• If you fail to repay a debt to a family member,
will there be hard feelings?

When there’s not enough money to pay every-
thing, look at what will happen if you don’t
immediately pay each debt. If the loan is se-
cured, you stand to lose your collateral.

Here are some examples of debts you want to
pay back first:

Mortgage  Landlord
Secured loans  Insurance
Utilities  Auto loans
Telephone
Some examples of second priorities are credit cards and finance companies (if unsecured debts). Some examples of third priorities are doctors, dentists, and hospitals.

**Contacting your creditors**

Once you have calculated how much money your family has for monthly living expenses and for paying off debts, decide how much you can pay each creditor. Work out a repayment plan that shows how much you plan to pay each creditor.

Now you are ready to contact each of your creditors to explain your situation and work out a solution. Be prepared to explain the reason you cannot pay, your current income and prospects for future income, your other obligations, your plans to bring this debt up-to-date, and the amount you will be able to pay each month.

Visit local creditors in person. Visit the loan officer at your bank or credit union, the credit manager of local stores, and the billing office of your dentist, physician, clinic, or hospital. Some businesses, such as utility companies, have special counselors for customers who can’t pay their bills. These counselors can help you set up a budget plan to even out your payments during the year. They also tell you if you qualify for fuel assistance or any available programs.

Contact out-of-town creditors by phone or letter. If you phone, write down the name and title of the person to whom you talked. Follow the conversation with a letter, spelling out the agreement between you and the creditor. Keep copies of your letters as well as any reply.

As you negotiate with each of your creditors, don’t agree to any plan simply to get off the hook. Establish a repayment plan that is acceptable to both you and the creditor.

You pay.

Here are some alternatives to consider when negotiating with your creditors:

- Reducing the monthly payment.
- Refinancing the loan.
- Deferring a payment for a short time if you expect your income will increase soon.
- Reducing or dropping late charges.
- Paying only interest on the loan until you can resume making monthly payments.
- Voluntarily surrendering or giving back an item purchased on credit.
- Selling the item and using the cash to pay or partially pay the debt (you are still responsible for any remaining balance).

Not all creditors will be willing to accept alternatives. However, they’ll be more likely to work with you if you contact them before they contact you. If you owe a large amount of money, and if your creditors won’t accept reduced payments or a negotiated plan, you may consider taking a debt consolidation loan. You may even have to consider more extreme alternatives such as Chapter 13 bankruptcy, or as a final resort, Chapter 7 bankruptcy.

**Debt consolidation**

Debt consolidation loans are issued in Indiana by licensed banks, savings and loans, credit unions, and finance companies. You take out a cash loan to pay your creditors. Your new debt, then, is owed to the financial institution that makes the loan. This type of loan may be useful, under certain circumstances, when you are having trouble meeting current obligations. In some instances, you can use a home equity loan for debt consolidation. However, if you are unable to repay the loan, you lose your house.

With a debt consolidation loan, your monthly loan payment is less than the total of individual debts you had before. You should be aware, though, that commercial debt consolidation and home equity loans cost money and almost always extend the life of your debts. Debt consolidation
loans in Indiana are regulated under the Indiana Uniform Consumer Credit Code. The maximum annual percentage rate (APR) that can be charged on a debt consolidation loan is:

<table>
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<tr>
<th>Loan Amount</th>
<th>Maximum APR</th>
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<tbody>
<tr>
<td>$0-$1,020</td>
<td>36%</td>
</tr>
<tr>
<td>$1,021-$3,400</td>
<td>21%</td>
</tr>
<tr>
<td>$3,401 +</td>
<td>15%</td>
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</tbody>
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Financial institutions also have the option of charging a flat 21% annual percentage rate on consolidation loans. If you are considering a consolidation or home equity loan, contact several financial institutions and ask what annual percentage rate they would charge on a loan for the amount you need. Ask if there are any other finance charges associated with the loan. If you choose this route, be sure to shop around for the best terms. And don’t be fooled into thinking that a consolidation or home equity loan has solved your financial troubles. You will still need to exercise financial care until your income rises again.

**Bankruptcy**

If your financial affairs have deteriorated beyond repair, bankruptcy is a last recourse. Bankruptcy laws were designed to release persons of insupportable debts and spare the individual undue harassment by creditors. While there are no hard-and-fast rules, bankruptcy might be a consideration if: 1) your creditors are unwilling to renegotiate debts, 2) you cannot obtain a consolidation loan, 3) no other source of help is available, 4) essential expenses do not exceed 75 percent of your take-home income (as in Chapter 13).

“Bankruptcy” really includes three choices — Chapter 13, Chapter 7, and Chapter 11.

Chapter 13 allows the debtor, acting through a bankruptcy trustee, to work out a whole or partial repayment plan, if creditors agree. Payments are made to the court, interest charges stop on the date of the filing, and the payment schedule stretches for a period of three to five years.

Chapter 7 bankruptcy is also called “voluntary” or “straight” bankruptcy. Under Chapter 7, when a petition is filed for bankruptcy, it must include a list of all assets and liabilities. The court can liquidate major assets with the exception of certain personal possessions. Chapter 7 bankruptcy theoretically wipes the financial slate clean. The potential stigma of taking bankruptcy should be carefully considered, however.

Chapter 11 is especially for business bankruptcies. In most cases of bankruptcy, the advice of an attorney is desirable; in Chapter 11, the services of an attorney are vital.

Bankruptcy information and regulations change regularly. Contact the United States Trustee Program for current information about the federal bankruptcy system. You can call (317) 226-6101 or (574) 236-8105 or go online to [www.usdoj.gov/ust](http://www.usdoj.gov/ust).
The publications in this series

1) Don’t Panic – Take Control (CFS-704-1-W)  
www.ces.purdue.edu/extmedia/CFS/CFS-704-1-W.pdf

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