5 Ways to Get out of Debt

Written by Zina Kumok
Bankrate

Getting out of debt isn't easy. Sometimes it takes all you have to keep up with monthly bills and save for a rainy day, let alone pay the minimum monthly payments on your credit card. Fortunately, there are plenty of ways to get out of debt that won't make you miserable. Here are some of the best strategies to become debt free in the new year.

What's the average debt per person?

According to the 2019 Consumer Debt Study from Experian, the average American had $90,460 in debt in 2018. This number includes mortgages, credit card balances, auto loans, personal loans and student loans.

Here's how it breaks down by generation:

Age group	Average debt load
Gen Z (18-23)	$9,593
Millennials (24-39)	$78,396
Gen X (40-55)	$135,841
Baby boomers (56-74)	$96,984
Silent generation (75+)	$40,925

How debt can negatively impact your life

Being in debt can make qualifying for other loans more difficult. For example, if you want to buy a house, most lenders require that you have a debt-to-income (DTI) ratio of 43 percent or less, including future mortgage payments.

The DTI ratio is calculated by adding up your current monthly debt payments and dividing them by your monthly gross income. Let's say you have a $300 student loan payment, a $500 auto loan payment and a $200 minimum credit card payment. Your monthly gross salary is $3,750, which makes your DTI 26.67 percent. In this instance, the maximum mortgage payment you would qualify for is $612.50. Depending on your location, it could be almost impossible to find a home within that price range.

If your DTI already exceeds 43 percent without a mortgage payment, you may find it impossible to qualify for a mortgage. Having too much debt can also make it harder to save for retirement, your child's college education or other goals.

Additionally, if you work in law enforcement, financial services or the military, your employer may conduct a credit check when you apply. You may be rejected if you have too much debt, because a vulnerable financial situation puts you at a statistically higher risk for accepting bribes.

Organize all of your debt and bills

Before you can devise a debt paydown strategy, you should compile a list of all of your current bills and loans. Go through your bank and credit card statements for the past six months and write down all the recurring loans, bills and other fixed expenses.

Your list should include the monthly payment, total balance, interest rate, term and any other relevant details. For example, you should note if any of the loans are currently in deferment or on a special repayment plan.

To double-check that you haven't missed anything, look at your credit report to see all current loans and lines of credit. You can check your credit report for free once a week through AnnualCreditReport.com until April 2021. After that, it will be free once a year.

Make sure to view your credit report from all three credit bureaus. Some lenders don't report credit activity with all three, so if you only check one or two you may be missing important information.

Strategies to get out of debt

If you're ready to get out of debt, start with the following steps.

1. Pay more than the minimum payment

Go through your budget and decide how much extra you can put toward your debt. Paying more than the minimum will save you money on interest and help you get out of debt faster.

Let's say you have a $15,000 balance on a credit card with 17 percent APR and a $450 minimum payment. If you only make the minimum payment, it will take you almost four years to repay the balance. You'll pay about $5,500 in total interest.
If you paid $550 a month, or $100 more than the minimum, you could repay the debt in less than three years and pay only $4,100 in total interest. To learn more, try using a credit card payoff calculator.

2. Try the debt snowball

If you're paying more than the minimum payment, you can also try the debt snowball method for debt reduction. This debt repayment method asks you to make the minimum payment on all your debts except for the smallest one, which you'll pay as much as you can toward. By "snowballing" payments toward your smallest debt, you'll eliminate it quickly and move on to the next smallest debt while paying minimum payments on the rest.

Let's say you have a $5,000 credit card balance, an $1,000 auto loan and $10,000 in student loans. With the debt snowball method, you would focus on paying off the auto loan first, because it has the lowest total balance.

The debt snowball method can help motivate you to focus on one debt at a time instead of multiple, helping you build momentum and stay on track. The only time you should disregard the debt snowball method as an option is if you have a payday loan or a title loan. These loans usually have much higher interest rates, between 300 percent to 400 percent APR on average, and should be paid off as soon as possible.

3. Refinance debt

Refinancing debt to a lower interest rate can save you hundreds in interest and help you repay debt faster. You can refinance mortgages, auto loans, personal loans and student loans.

One way to do this is through a debt consolidation loan, which is a personal loan that may come with lower interest rates than your existing debts. If you have credit card debt, you may also consider transferring the debt to a balance transfer card. These cards have 0 percent APR for a specific time frame, usually between six to 18 months.

4. Commit windfalls to debt

When you get a tax refund or stimulus check, add the money to your loans instead of saving it in your bank account or splurging on yourself. You can decide to commit the entire windfall or split it 50-50 between debt and something fun, like a future vacation or expensive dinner.

5. Settle for less than you owe

You can also call creditors and negotiate a settlement of your debts, usually for a lot less than you owe. While it's possible to take care of this yourself, an array of third-party companies also offer debt settlement services for a fee.

While paying less than you owe and escaping old debts may seem smart, the Federal Trade Commission does mention some risks. For starters, some debt settlement companies ask you to stop making payments on your debts while you're negotiating better terms, which can negatively impact your credit score.

Source: https://www.bankrate.com/personal-finance/debt/ways-to-get-out-of-debt/