
Dealing with a Drop in Income



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Learning for life

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Prepared by: Peggy Olive, Family Living Agent, Richland County UW-Extension, February 2009.
Resources: *Managing Between Jobs: Deciding which bills to pay first; Talking with creditors.* UW-Extension, 2006.
Surviving Debt. National Consumer Law Center, 1999.

In addition, you may find the following website helpful during difficult economic times:
<http://www.extension.org/Financial%20Crisis>

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When your income drops...

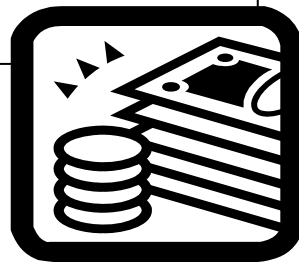
Sometimes a household's income drops suddenly because of a job layoff, an illness or death, or a divorce. It's natural to feel shocked or panicked or to want to ignore the situation.

Whatever the cause, the best thing you can do is to figure out if your new income covers all of your current expenses. Most households can't continue to spend at the same rate and with same lifestyle that they had before their income dropped – even if the drop is just temporary. The sooner you look at your household budget, the more options you have and the better off you will be in the long run.

As hard as it is, you need to let your creditors know about your financial situation. Some of your creditors may be willing to work with you during a rough patch if you're honest with them and contact them before you miss any payments.

Talk with your family and friends about your stress and the changes that might need to happen at home. If you have children at home, you don't want to worry them with adult concerns about paying for groceries or the mortgage, but it's okay to let them know that there's less money coming into your home. Children can be part of the solution when you let them know that some purchases can't be made or some activities will need to be cut or postponed. Your teens might already be contributing to the family budget through a part time job. Families often come out stronger when everyone pulls together.

No matter how bad your situation might be, ignoring your worries won't make them go away. Take charge.



MONTHLY CASH FLOW WORKSHEET

When you have a sudden drop in your income, the first step is to figure out what your current income will be and how much your monthly living expenses add up to. Use this worksheet to estimate if your income will cover all of your current expenses and debt payments.

Basic Living Expenses

<i>Monthly Expense</i>	<i>\$ Amount</i>
Rent/Mortgage	
Electricity	
Heating Oil or Gas	
Water/Sewer	
Cable/Satellite	
Phone/Internet	
Cell Phone	
Gas for Car	
Car insurance payment	
Eating Out	
Groceries	
"Stuff" for household & personal care	
Clothing and Laundry	
Doctor co-pays/ Prescriptions	
Entertainment – movies, hobbies, habits	
Pets	
Gifts/donations	
Health/Life insurance	
Emergency Savings	
Other Savings	
TOTAL EXPENSES	\$
+ TOTAL MONTHLY DEBT PAYMENTS	\$
= TOTAL MONTHLY SPENDING	\$

Debts

<i>Name of Creditor</i>	<i>Monthly Payment Requested</i>	<i>Total Amount Owed</i>
Car Payment	\$	\$
Medical Bill		
Past Due Utilities		
Cash Advances		
Credit Cards		
TOTAL DEBTS	\$	\$

TAKE HOME INCOME/PAYCHECKS

Income (1) \$ _____

Income (2) \$ _____

Income (3) \$ _____

Income (4) \$ _____

TOTAL MONTHLY NET (TAKE HOME) INCOME \$ _____

If your total spending is more than your total monthly take home pay, keep reading to find out more about working with creditors.

Where do you start if you can't pay bills?

Take action right away_____

Contact creditors BEFORE you miss a payment. You can reduce your chances of being harassed by creditors or collection agencies by working out solutions early.



At the first sign that you will not be able to make a payment, do the following:

- **Work out your new income and expenses.** Use a monthly spending plan worksheet to compare your income to current expenses. This will give you a picture of your current spending and possibly places to cut back on your day to day expenses.
- **Prioritize your bills.** Credit card collection agencies can be rude and persistent if you miss a credit card payment, but missing a mortgage payment could mean losing your house. Figure out what other bills are priorities to you, for example, the car payment or groceries. See *“Deciding which debts to pay.”* After you set aside enough money for priorities, then divide the rest of your income among the other creditors and bills.
- **Contact your creditors before they contact you.** When you contact creditors, you'll need to work with someone—a supervisor, accounts manager, or “loss mitigation” specialist—who can negotiate with you. When you call, this may mean getting busy signals or spending some time on hold since many others in similar situations may be calling too. If the creditor is local, make an appointment to meet with them in person.
- **Make specific and realistic offers to creditors.** A creditor does not have to accept a lower payment from you, but it never hurts to ask and explain your situation. Agreements may include lower payments over a longer period (with more interest added) or payment on interest alone for a set time period. Don't make promises you can't keep.



- **Follow up with a letter detailing the arrangements you agreed to with each creditor.** In the letter, write down the terms of your agreement including amount and due date, the name of the person you talked to, and the date. Keep a copy of the letter for your records. Get agreements in writing and signed by the creditor before you send in payments.
- **Contact a credit counseling agency** if you need help working with your creditors. Be aware that these agencies charge a fee to help you and a debt repayment program may affect your credit rating.
- **Consider seeking legal advice.** You have rights under the Consumer Protection Act. If a creditor has filed a judgment against you to garnish your wages or repossess collateral, you may want to speak with an attorney before the court date.
- **Don't take on new debt.** You may be tempted to use credit cards, take out a home equity loan, or borrow money to pay bills. Unless your situation turns around quickly, more debt only creates bigger problems.

WHAT ABOUT YOUR CREDIT RATING? Nonpayment of bills is reported on your credit record, which can damage your ability to get credit or increase the cost of credit. A prospective employer may ask to see your credit record. If you contact all creditors immediately and pay something on each debt as agreed, creditors are less likely to report problems to credit bureaus.

What can happen when you don't pay bills?

If you have emergency expenses or a sudden drop in income, you may be tempted to ignore bills or credit charges. Here is what may happen if you put off paying bills:

Utilities

- **Utility service may be shut off.** Services such as electric, gas, or your cell phone may be turned off if you don't pay bills. Also, you may not qualify for energy assistance if you owe money to the utility company.
- **A large reconnect charge** may be difficult to pay later.
- **Interest and fees** may be charged on overdue amounts.



Mortgage

- **Default** - If you miss a mortgage payment, you will receive notice from your lender that foreclosure will begin if you do not pay by a certain date.
- **Late fees** will be added to the amount you owe.
- **Cosigner will be asked to pay** - If a relative or friend cosigned the mortgage, the lender will expect them to make the payments if you do not. Your missed payments could create serious problems for your cosigner as well.
- **Foreclosure** - If you continue to not make payments, the lender will ask the courts to auction your home so the lender can regain the money owed. If this happens, you could lose your home, all of your money invested in it, and still owe more money to your lender. You may want to consider selling your house before court action begins.

Other Creditors

- If you miss a payment, you will **receive a letter** reminding you that you missed a payment and asking you to pay promptly. After that, you may receive a more direct letter or get a phone call demanding payment.
- Bills will probably be **turned over to an independent collection agency**. At that point, you will no longer be able to negotiate with the person or company you owe money to. Collection agencies can be aggressive, but you do have certain rights. Collection agencies can't use abusive language or threaten you with violence. They can't call you at unusual hours or threaten criminal prosecution. And they can't discuss your financial situation with others.
- Creditors can take several kinds of **legal action** against you. These actions are often written into the sales contract you signed. If you fail to make payments, you will receive letters from a creditor's attorney warning you of the action the creditor plans to take.
- **These actions may include:**
 - < **Acceleration** – the entire debt is payable at once if you miss a payment. The courts can force you to pay by seizing your property and selling it.
 - < **Repossession** – the creditor can seize the item you bought or the property you used as collateral. If the sale of the property brings less than the amount you owe, you still must pay the difference.
 - < **Wage garnishment** – a court order or judgment that requires your employer to withhold part of your wages and pay your creditor. The creditor can also garnish your checking or savings account if you have more than \$1000 in your account.



Government Debts

- Debts like property taxes or child support are handled differently than a loan or credit card payment. See *"Deciding which debts to pay"* for more on these debts.

Deciding Which Debts to Pay First

When you are between jobs, the paychecks may stop coming, but the bills don't. You're legally obligated to pay all debt, but when you don't have enough money to cover your monthly expenses and pay your creditors the minimum amount due, you face some tough decisions. There is no magic list of the order in which debts should be paid since everyone's situation is different.



Here are some general rules about how to set priorities:

- 1. First, pay housing-related bills.** Keep up rent or mortgage payments if at all possible. Failure to pay these debts can lead to loss of your home.
- 2. Pay basic living expenses next.** This includes groceries and medical insurance if you can afford the premiums. Your reduced income may qualify you for FoodShare food assistance or BadgerCare medical assistance. Check out access.wisconsin.gov or contact your county human services office to see if you qualify.
- 3. Pay the minimum required to keep essential utility service.** Full and immediate payment of the entire amount of the bill may not be required, but you should make the minimum payment necessary to avoid disconnection if at all possible.
- 4. Pay car loans or leases next if you need to keep your car.** If a car is needed to get to work, you will usually make the car payment the next priority after housing, food, and utilities. Your creditor can repossess your car without going through the courts first. If you keep the car, stay current on insurance payments as well to avoid additional fees, legal problems, or an overwhelming expense from an accident.
- 5. Make tax debts a high priority.** You must pay any income taxes owed that are not automatically deducted from your wages and any property taxes if they are not included in your monthly mortgage payment. You must file your federal income tax return, even if you cannot afford to pay any balance due. The government has many collection rights that other creditors do not have. Also pay child care; these debts are court-required and will not go away. Nonpayment can result in very serious problems, including prison for nonpayment.
- 6. Make student loans a medium priority.** In general, pay them ahead of low priority debts but after top priority debts. Since most student loans are backed by the government they are subject to special collection remedies, such as wage garnishments, seizure of tax refunds, and denial of new student loans and grants.

Government Debt

Income Taxes: If you cannot pay the total amount due, contact the Wisconsin Department of Revenue and the IRS right away. Ask for information on repayment plans and find out whether your reduced income makes you eligible for tax credits. Contact the Wisconsin DOR at (608) 266-7879 or www.dor.state.wi.us. There's a \$20 fee to make an installment agreement. Contact the IRS at (800) 829-1040 and ask to be transferred to "advanced accounts."

Property Taxes: Contact your county treasurer and explain your situation right away if you're not able to pay property taxes.

Child Support Orders: If your income has dropped sharply, contact your family court to find out about lowering your support order as soon as possible. This cannot be done retroactively.

Student Loans: If you are having trouble making your federal student loan payments, contact your loan servicer immediately. You may be able to have payments **deferred** – or postponed – during periods of unemployment or financial hardship. But you cannot qualify for a deferment once your student loan is in default.

7. **Make loans without collateral a low priority.** These include credit card debts, doctor or hospital bills, other debts to professionals and similar obligations. Since you have not pledged collateral for these loans, there is rarely anything these creditors can do to hurt you in the short term.



8. **Make loans with only household goods as collateral a low priority.** Creditors rarely seize the goods due to their low market value and the difficulty in retrieval without involving the courts. If the creditors do start actions to repossess household items, you will be notified by letter.

9. **Treat cosigned debts like any others.** For example, if you put up your home or the car as collateral, that is a high-priority debt for you if other cosigners are not keeping the debt current. If you have put up no collateral, make the debts a low priority. If others have cosigned for you, you should let them know about your financial problems so that they can decide what to do about the debt.

10. **Don't pay when you have a good legal reason to not pay.** Examples include defective merchandise or the creditor is asking for money that it is not entitled to. If you believe you have a legal defense, contact a lawyer.

11. **Don't move up a debt's priority based on threats to ruin your credit report.** In most cases, the creditor has already reported the delinquency to a credit bureau.



12. **Don't move up a debt's priority because of debt collection efforts or threat of a lawsuit.** Be polite to a collector, but make your own choices about which debts to pay based on what's best for you. Many threats are not carried out, and the procedure itself is long and complicated for the creditors. On the other hand, nonpayment of rent, mortgage, and car debts may result in immediate loss of your home or car.

13. **Do move up court judgments in priority if the creditor has already sued.** After a court judgment, that debt should move up in priority because the creditor can enforce that judgment by asking the court to seize your property, wages, and bank accounts.

14. **Be cautious about consolidating debts or refinancing your home.** Depending on your situation, this may or may not be the right option for you. It can be expensive and give creditors more opportunities to seize your important assets. A short-term fix can lead to long-term problems.

Bankruptcy

If you owe a large amount of money and your creditors will not accept reduced payments, you may have to consider your option of last resort - personal bankruptcy. A bankruptcy stays on your credit report for 10 years, making it hard to get credit, buy a home, get life insurance, or sometimes get a job. However, it is a legal procedure that can offer a fresh start for people who can't pay all their debts. Filing for bankruptcy could cost between \$1000-\$2000. While it is possible to file a bankruptcy case "pro se," that is, without the assistance of an attorney, hiring an attorney is recommended. Contact the Wisconsin Bar Association Lawyer Referrals numbers: (608) 257-4666 or 1-800-362-9082 look in the phone book for "Bankruptcy" listed as a specialty branch of the law.

Sample letter to creditors

Use this example below as a guide when writing to or talking with creditors. Replace the blanks with your own information.



(Creditor/Company name)

(Company Address)

(City, State, Zip)

Attention: Account Representative

Date: _____

Name(s) on account: _____

Account number: _____

Date loan/account opened: _____

Total amount due: _____

Monthly payment amount: _____

This letter is to let you know that I'm currently having some financial difficulties. I'm not able to pay the complete monthly payment on my account because _____.

(List your personal reason here – job loss, illness, etc.)

Looking at my financial situation, I have set up a budget for my basic living expenses and have come up with a debt repayment plan based on my reduced income. I'm contacting all of my creditors to explain my situation and to ask for a reduced payment until my situation improves.

I would like to offer a reduced payment of \$_____ per month. This is the most that I can pay regularly at this time. You can expect this amount as soon as possible until the debt is totally repaid.

I hope you find this repayment amount acceptable. I look forward to your letter of acknowledgement. Thank you.

Sincerely,

(Sign your name)

(Your address)

(City, State, Zip)

Tips to negotiate with creditors:

Not all creditors will accept payment plans, but they'll be more likely to work with you if you have been a good customer and if you contact them before they contact you. Before you contact each creditor, make sure you'll be able to pay the monthly amount in your agreement. If you fail to follow the new plan, your creditor will be less likely to work with you again.

Here are some options you could request from your creditor:

- Reduce your monthly payment amount
- Reduce or drop charges for late payments
- Refinance the loan at a lower interest rate
- Pay interest only on the loan until you can resume making monthly payments
- Request permission to sell the item and use the cash to repay – or partially repay – the debt.