



# Paying Creditors and Maintaining Your Financial Reputation

**I**f your income suddenly drops because of things you cannot control—such as being laid off or suffering a major illness—remember that you are not the first person this has happened to, nor will you be the last. How you manage until your income returns to normal will depend on how you approach the situation. By thinking through your options two to three days after learning about the income drop, you are more likely to handle the situation in ways that benefit you and your family.

## Taking Matters into Your Hands

You must take action before you have trouble repaying bills. Talk to your creditors. If you are unable to pay your bills, many creditors may be willing to work with you to adjust payments until your financial situation improves. Explain the situation to them in writing and follow up with a telephone call. If necessary, offer an alternative to current payment schedules after you have evaluated your debt and income status.

### Step 1

Make a list of your creditors by name. Include everyone you owe money to and all recurring bills. (See inside page.)

### Step 2

Record vital information about creditors in a chart format that makes it easy for you to analyze your financial obligations. (See inside page.) If you have thrown away past billing statements, companies may provide the necessary information by telephone.

### Step 3

Identify the bills that would cause the most hardship or stress on you and your family if they were not paid. These are likely to be secured debts, which are backed by some form of collateral such as land or another asset that can be sold easily.

### Step 4

Decide on the order in which bills must be paid.

### Step 5

If your current income is not enough to cover existing bills, find ways to reduce the cost of recurring bills such as utilities and telephone service.

## Step 6

Get a second opinion on your bill-payment strategy. Take your debt and income information to two or three nonprofit credit counselors. They may have suggestions that you have not considered. Nonprofit credit counselors can be found in the yellow pages of your local phone book under “credit or debt counseling.” You also can contact your county’s Penn State Cooperative Extension office (see the local county government listings in the white pages) or the state attorney general’s office for assistance in locating reputable nonprofit credit counselors. Avoid agencies that charge you fees for a consultation. Some nonprofit credit counseling agencies will charge a small fee to handle bill payments if you agree to work with them to repay bills. Never pay or work with an agency that guarantees it can fix your credit problems.

### Which Bills Should You Pay First?

Individual circumstances and the best options for families will differ. The following priorities usually apply to most families when paying debts on a suddenly reduced income.

#### High-Priority Bills

- Family necessities, such as food, and critical medical needs, such as diabetes medication
- Housing expenses (mortgage or rent and related insurances, property taxes)
- Any loans for which your home has been used as collateral
- Essential utilities (electric, gas or oil, telephone)
- Car loans
- Child support
- Unpaid income taxes
- Other secured loans (loans backed by some form of collateral or property that guarantees payment)

#### Medium- to Low-Priority Bills

Paying the following bills late will damage your credit rating and decrease your ability to get credit in the future. However, late payments or nonpayment will not immediately jeopardize your family’s food and shelter.

- Unsecured debt such as credit cards, charge cards, department store and gasoline cards
- Student loans
- Installment loans on household goods
- Loans without collateral, such as attorney’s fees and doctor and hospital bills

### Determine Household Monthly Net Income

	Amount
You	
Spouse or partner	
Other household member	
Other sources of income	
<b>Total monthly income</b>	

## Determine How Much You Owe

Bill categories	Total amount due	Payment amount and frequency (weekly, monthly, semi-annually, yearly)	Payment due date	Can we live without this until our income increases? (Yes or No)	Is this debt secured (backed with some collateral)? (Yes or No)
<b>Housing Expenses</b>					
Mortgage or rent					
Fire or rental insurance					
Real estate taxes					
Other					
<b>Utilities</b>					
Gas					
Electric					
Water/sewer					
Telephone					
Cable					
Other					
<b>Food</b>					

**Determine How Much You Owe**

<b>Bill categories</b>	<b>Total amount due</b>	<b>Payment amount and frequency (weekly, monthly, semi-annually, yearly)</b>	<b>Payment due date</b>	<b>Can we live without this until our income increases? (Yes or No)</b>	<b>Is this debt secured (backed with some collateral)? (Yes or No)</b>
<b>Medical</b>					
Maintenance drugs					
Other					
<b>Life Insurances</b>					
<b>Transportation</b>					
Car 1					
Car 2					
Insurance 1					
Insurance 2					
Other					
<b>Child support</b>					
<b>Credit, charge, or store cards</b>					
<b>Other loans/debts</b>					

## Questions to Consider for Each Debt

- Will the creditor accept a reduced payment? How long will a lower payment be accepted?
- Will the creditor reduce or eliminate the finance charge? If so, for how long?
- What is the reconnection fee if this service is discontinued and restarted later?
- Can I perform a service for the creditor in lieu of payment? If so, make sure the agreement is written.
- Is there a local source of temporary help for this bill?

## Last-Resort Alternatives

If you cannot pay your bills on your current income and an increased income in the near future looks unlikely, two last-resort alternatives exist: debt consolidation and bankruptcy.

Before considering these alternatives, explore every available option and make sure you understand the short and long-term impact of these choices on your family, your ability to get credit in the future, and your credit history and rating. Also, make sure you understand the total dollar cost of these alternatives. Do not sign an agreement for a debt consolidation loan or bankruptcy until you have answers to these questions in writing.

### Debt Consolidation

Debt consolidation loans are those in which you get enough money from a finance company, bank, or credit union to pay existing bills. In return, you make a single payment to the lender until you have repaid the loan. You may be required to have some form of collateral, such as a house or land. Your repayment period will be longer and the annual percentage rate (APR) of a debt consolidation loan usually will be higher than the APR for other types of loans. Before selecting this option, compare the terms offered at various lending institutions in your area (banks, credit unions, finance companies). Never borrow more than you need. If lenders offer to give you more than you request, consider the cost to you before accepting the loan. Who will benefit from the extra amount borrowed?

## Bankruptcy: The Last Resort for the Overindebted

There are several forms of bankruptcy available to those who find themselves overextended in debt. Each type is briefly explained below. In short, when you file bankruptcy, your debts are canceled and you are allowed to start over fresh. Bankruptcy should be your last resort. It carries a high price that many people do not understand until after the process is over. It can be a decision that you regret for up to 10 years. If you consider bankruptcy, get a book from the library to read before proceeding. Ask questions of professionals you may be consulting. Make sure you understand the monetary cost of filing for bankruptcy (attorney fees and bankruptcy filing fees). Talk to more than one professional before making a decision. Evaluate the advice of professionals and ask yourself what will they gain if you follow their advice.

### Chapter 7 Bankruptcy

With this type of bankruptcy, which is available to individuals and businesses, you ask the court to erase your debts completely. You will be required to give up property that is nonexempt. This is also known as liquidation or straight bankruptcy.

### Chapter 13 Bankruptcy

Also known as “reorganization,” this type of bankruptcy is available to individuals. With Chapter 13, a plan to repay your creditors is developed and agreed upon. Usually, a repayment plan can be as long as five years. You pay the court or bankruptcy trustee and they pay your creditors.

### Chapter 12 Bankruptcy

This type of bankruptcy is available to family farmers.

## References

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