



**Nelmes Financial**

Conversations About Money®

# Budgeting is Broken

Get what you really want.

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11 Debt

*This system is constantly being revised; any suggestions or comments are encouraged and appreciated. I can be reached at [chris@nelmes.ca](mailto:chris@nelmes.ca).*

*Note: It is important to remember that everyone is different and your solution needs to fit your lifestyle, spending habits, values, and goals. Modifying the program to fit your unique situation is ideal and encouraged.*

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## Steps to set

### A simple approach to debt repayment

Paying down debt has become one of the simplest ways to increase long term lifestyle goals and create strong personal cash flow. It is also an amazing way to live, as debt too often adds stress and pressure to our lives. The following pages contain some considerations when planning to pay down your current debt load and a checklist to help you create your own debt payment plan.

### Other Debt Options

There are of course other options, besides paying down your debt. Two of the most common options are Bankruptcy and debt arbitration. These options are not ideal and should be avoided, however if you have more debt than you can pay off they should seriously be considered. Too often I see people struggling with debt refuse these options initially, and continue to struggle for months or years before coming to the realization that they need to take these steps. These options are there for a reason, and I do believe we should all work to make sure we do not end up needing these, if you are buried in debt and unable to cover your payments these a good options. They allow you to stop the struggle and start building a life again.

### Allocating your funds to debt repayment

Making the minimum debt payments is never a good long term strategy, so where should we put any extra funds we find as we work to pay off debt? First we need to find the minimum payment, which is simply the total of all your minimum payments. Then decided how much more you can spare to also contribute to paying down debt. With this step it is important to remember that every dollar spent here will save you many more, and the more you pay down the faster you will be free from the burden of your debt. I also believe that you do need to live as well and a balance that fits you must be found.

Every month it is important you make the minimum payments on all your debts, and then put any amount left over on the debt you wish to pay off first. As you eliminate a debt, simply move the remaining money allotted to debt repayment onto the next debt you wish to pay off. As each debt is paid off a larger payment is applied to the next.

It is important to remember that the progress when paying down debt often starts out slowly, but picks up and keeps getting faster and faster if you stay on track.

### Dealing with the weight of debt.

I often find that after starting debt repayment the initial focus tends to fade. One of the best tools to overcome this is simply tracking your success. Create a net worth statement and every month update it. As your debt decreases it will illustrate your progress. You can also just list your debt and as you pay this off it this will also track your success. Check out the cash flow section on the [www.nelmes.ca](http://www.nelmes.ca) site.

Too often with our finances we focus on what we lack, or the debt we have, and spend very little time if any with the financial successes we have had and recognizing the accomplishments we have made. Focusing on failure breeds failure, focusing on success leads to more success. This step is commonly overlooked, but dramatically increases not only the odds of success, but also usually leads to a faster result.

### Other considerations.

Before completing your debt plan there are a few things you should consider as they may affect what choices you make. I always recommend talking to a professional about the details of your situation, as things change all the time and every area and situation is unique.

*Loans versus lines of credit.* When paying down debt it is important to note the difference between paying down a loan and paying down a line of credit. With a loan, once you have paid it down the funds are gone, no longer available. This is good as it keeps you from re-borrowing and going back into debt. This is also bad as if you have an unexpected expense arise and you have put all your extra funds on loans, you may not be able to find the money required to pay the unexpected bill.

Credit cards are just like a line of credit this way, they give you flexibility to re-borrow. It is up to you whether this is good or bad.

*Credit Score.* When paying down debt it is common to look at consolidating or rolling the debt into your mortgage. If you are looking at these options it is a good idea to look at how your debt is impacting your credit statement. These rules can change and different companies do have different ways of scoring, but the following are some things to think about.

1. With credit cards or lines of credit, owing more than half the limit can hurt your credit score.
2. Every bill must be paid on time.
3. Minimize the hits on your credit.
4. There are many others, it is important to discuss with someone that knows what is current in your area.

*Debt Consolidation.* This can be the best and worst option.

Benefits.

Consolidating debt can reduce interest cost and make paying back debt much easier. Also one bill is much simpler to remember; drastically reducing the chances you will miss a payment (as many debts have steep penalties for this). A consolidation loan or rolling the debt into the mortgage is the easiest way to move forward.

Downside

I see too many people consolidated debt and make the following mistakes.

1. Take the smaller payments putting the debt over a long period of time and spend the difference.
2. Start racking up the debt that got them into trouble in the first place.

Debt consolidation is a great tool, however it is important that you plan to pay it off as soon as possible and make sure you stay out of debt.

When looking at consolidating you have the option of applying for a loan, or rolling the debt into your mortgage. The benefit for the loan there is usually no fees, and usually it only last for a few years. The benefits to the mortgage is it may be easier to qualify for, the rate is often lower and the payment is usually smaller. Mortgages often require fees and paying the debt back over a long period of time is never ideal.

Time to start organizing your debts.

When looking at debt repayment the first step is to chart out where you are. List all of your debts, credit limits, current balance, minimum payment, interest rate and payment date. I recommend creating this list in spreadsheet program as it makes many of the other steps much easier. A template for this can also be found on at [www.nelmes.ca](http://www.nelmes.ca).

With this list, create two new lists. The first list sort by interest rate, the highest interest rate first. The second list sorts your debt by balance. Start with the lowest balance first.

So why two lists? These two lists represent the two most common ways to attack your debt, both with defiant advantages.

*Focus on the rate.* The first list targets interest rate. Since the highest rate cost the most in interest, if look at this as a math problem this is the obvious solution. By putting all available resources towards reducing your interest bill, each month this should free up more money to pay off your debt.

*Focus on Success.* The second list focuses on the remaining balance, with the smallest at the top of the list. Although the first should be the best, often this option seems to work better for many people. When paying off debts, missing a payment causes the rates to rise, by reducing the number of outstanding debts it helps prevent this from happening. I also believe that success leads to more success. As a debt is paid off, it is a victory, and usually feels great. As the smallest balance is often the easiest success you will accomplish this sooner and your odds of reaching the next success increase.

*So if there are two options which one is right for you?* Everyone is different, so in the end it is up to you which option you choose. I most often recommend combining the two. I pay off any small balances first, and then attack the debts with the highest interest rates. This creates successes initially and frees up money to tackle the larger debts.

Print the debt list in order of payment dates, with the debt you are targeting highlighted. This will help you make sure you pay the minimum ever month, as well as make it clear which debt you wish to pay down. It is also a good idea to print out the order in which you wish to target the debts for future reference.

I recommend getting a ruler and putting a line through a debt once it is paid off. It feels great to cross it off, and I like keeping all the debts, even the ones paid off on the list. I find as you cross off more and more debts, the list becomes a place of motivation, as the successes (crossed off debts) grow against the remaining, keeping your accomplishments in focus as you attack the next debt.

Once you have considered your options, it is time to create your debt plan. Follow the following checklist.

## Debt Repayment Planning Checklist

### Rolling the debt into the mortgage.

- Is it an option?  **Yes** /  **No**
- Do you qualify?  **Yes** /  **No**
- Does it work for you?  **Yes** /  **No**
- Does the savings out weight the fees?  **Yes** /  **No**

### Debt consolidation loan.

- Is it an option?  **Yes** /  **No**
- Do you qualify?  **Yes** /  **No**
- Does it work for you?  **Yes** /  **No**

### Reorganize debt.

- Can you move some debt to lower interest account?  **Yes** /  **No**
- What are the fees involved?  **Yes** /  **No**
- Are the fees worth it?  **Yes** /  **No**

### Planning repayment.

- Create a list of payment dates and minimum payments  **Completed**
- Create repayment list by considering smallest balance? Interest rate?  **Completed**
- Create a Net Worth Statement  **Completed**
- Print out above lists and net worth statements  **Completed**
- Set time to review your progress  **Completed**

Once done print the two lists created in the above step. These will become your guide as you pay down your debt. Also schedule time to review your plan