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SP710-A Tools for Money Management - Debt Repayment Plan Instructions

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UT Extension

SP710-A

Tools for Money Management

Debt Repayment Plan Instructions

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At a glance...

This money management tool has instructions for making a plan for paying off household debt. Use these instructions with the Debt Repayment Plan Worksheet (SP710-B).

What this money management tool can do for you...

A debt repayment plan will help you:

- Determine which debts to pay off first.
- Make a schedule for payments.
- Know how long it will take to repay or reduce your debt.

Tip

After you make your debt repayment plan, it's very important not to continue to add to your debt. Set a firm rule to make no new purchases on credit until your debt is paid down.

Use the worksheet (SP710-B) to decide which debts to pay off first and make a plan.

Step 1. If you're behind, catch up. Give priority to the debts that will keep your household running normally. Examples include

- mortgage and catch-up mortgage payments
- home equity loan payments
- late utility bills
- late auto loan payments
- child support payments

Note

Prior to making the Debt Repayment Plan, you should have completed the "List of Creditors" worksheet (SP709-B).

Make only minimum payments to other debts until you are caught up with these important past-due payments. (For more information about deciding who to pay when you can't pay everything, see "Who Gets Paid First?" UT Extension publication SP 708.)

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Step 2. After you're caught up with important late payments, decide how you will pay the remaining debt. Either of the following methods will work for organizing debt repayment. Choose the one that's best for your household:

High Interest Rate Method. Check your List of Creditors to see which of your debts has the highest annual percentage rate (APR). Pay as much as you can on that debt each month while continuing to make minimum payments to other debts. After the highest APR debt is paid in full, re-direct that money to the debt with the next highest APR, continuing until all the debt is paid. The advantage of the high interest rate method is that, in the long run, you pay out less overall by paying off your higher interest debts first.

Low Balance Method. Pay off the bills with the lowest balance first. For example, if you have only $200 remaining on a charge card, apply as much as you can to that debt and when it's paid, re-direct your money to the debt with the next lowest balance. While you will pay more in interest in the long run, this method may help you feel more motivated as each debt is paid.

Tip

Most people do not include their mortgage in a debt repayment plan. However, if you are behind in your payments you should allocate money to catch up. If you have a home equity loan, you should include it in your repayment plan.

How Repayment Methods Work…

An example of debts is listed in the table below. Minimum monthly payments total $900, but you are budgeting $1,200 a month to pay off your debt. You can begin to allocate $300 a month to paying extra.

Creditor	Current Balance	Interest Rate	Monthly Payment	Number of Payments Remaining
DressChic, 190 Warrenfield Towers, Chicago IL	$ 600	12%	$ 50	13
FleetMarine Financing, 990 Louisville Marina, Knoxville TN	$2,500	10%	$190	14
College Financing, 9991 Kingston Pike, Knoxville TN	$4,000	8%	$150	30
Maxideal Auto Financing, 777 Maxideal Bldg., New York NY	$11,000	9%	$350	36
Civic Card, 17843 Third Ave. N., Philadelphia PA	$8,700	13%	$160	83
Total	$26,800		$900	

High Interest Rate Method.

1. Pay $460 ($300 + $160) a month on the Civic Card (interest rate 13 percent) paying it off in 22 months instead of 83.
2. Meanwhile, you would have paid off the DressChic and FleetMarine accounts by continuing to make the scheduled payments, freeing up an additional $240 ($50 + $190) a month.
3. After paying off the other accounts, apply the extra money ($300 + $160 + $50 + $190) to increase the payment of the Maxideal account (interest rate 9 percent) until payoff.
4. After paying off the Maxideal account, apply the entire $1,200 to payoff of the College Financing account (interest rate 8 percent).

Low Balance Method.

1. Apply the extra $300 a month to the DressChic account, which has the low balance of $600. Paying $350 a month ($300+$50), you would pay off that account in two months.
2. After paying off the DressChic account, apply the extra to the FleetMarine account, paying $540 a month ($300 + $50 + $190) until payoff.
3. After paying off the FleetMarine account, make monthly payments of $690 ($300 + $50 + $190 + $150) to the College Financing account until payoff.
4. After paying off the College Financing account, pay $850 ($300 + $50 + $190 + $150 + $160) monthly to the Civic Card account.
5. After the Civic Card account is paid in full, apply the full $1,200 to pay off the Maxideal account.

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