LSS Financial Counseling

Cornerstone Two:

Debt Reduction & Asset Building

Four Cornerstones
of Financial Wellness

Table of Contents

Introduction

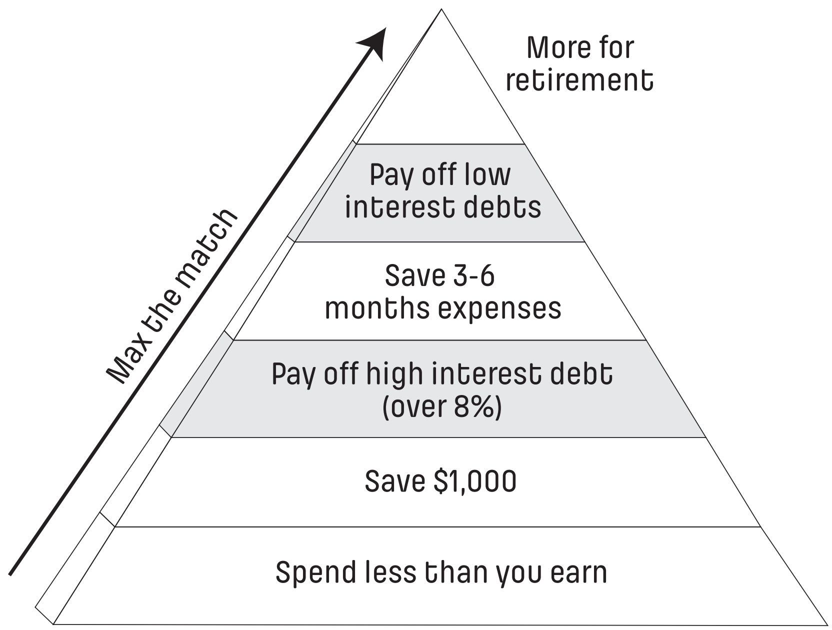
The goals for this section are to:

- **Prioritize debts for planning purposes.**
- **Understand the pros and cons of dealing with certain types of debt.**
- **Discuss different ways to build assets.**
- **Encourage ways to set aside money for the future.**
- **Create strategies to help you feel in control of your debts and investments.**

Access to credit is a good thing and it is important that everybody has the same opportunities. The use of loans allows many individuals to start a business or purchase a home. It is also important to know the benefits of asset building; for example, setting aside money for retirement as early as you are able.

While all that may be positive and good on one end, there are always dangers lurking on the other side. Taking on too much debt for smaller items may make it difficult to be financially stable. Only having access to subprime or predatory lenders can deprive communities of opportunities, affecting wealth accumulation for generations. Awareness of how different faiths manage loans and financial products without the use of interest can be important as well.

The Pyramid of Financial Wellness



Take Control of Your Debt: A Key Piece of Financial Well-Being

Our society makes it easy to get into debt. As we mentioned earlier, **access** to credit is good thing, but we want to avoid getting trapped in a debt cycle. We don't want to assume that everyone has debt, but it is good to know what to do in a variety of situations.

Here are three general rules to follow:

1. Pay more than the minimum amount due to your debts to get them paid off faster.
2. Don't "wait out" your debts by ignoring them.
3. Know your rights as well as how to deal with your debt.

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Different Types of Debt and How to Prioritize Them

FIRST: Secured Debts
Mortgage and Car Loan(s)

SECOND: Government Debts
Federal Student Loans, Taxes, Child Suppport

LAST: Unsecured Debts
Credit Cards, Medical Bills, Collection Accounts, Private Student Loans, Other Unsecured Loans

The goal is for all debt payments to be affordable in the budget, but there may be times when money is tight and decisions need to be made.

Using this chart creates a checklist to make sure debts are handled in the best way possible. In tough times, you might not be able to make payments on all your debts. Some lenders may offer deferment or forbearance options, or there might be community resources available to help make payments or get caught up on past due amounts.

Key Terms:

- **Secured Debt:** Requires a pledge to something like a car, house or savings account to get the loan, which the lender can take if you don't repay them.
- **Government Debt:** This includes unpaid taxes, student loans and child support. The government has strong collection powers and can take federal refunds, wages and other government income without taking you to court.
- **Unsecured Debt:** Does not require you to pledge assets; therefore, it might have higher interest rates.

Debt Timelines

If paying on your debts becomes difficult, it is important to know how much time you have available to work it out with your creditor or lender. This is an outline of the collection process and may vary.

Please note: Mortgage delinquency is a different process and needs to be treated separately.

30 to 90 days past due: Pre-Collections

Creditors might start to call. Statements show past due status and might charge extra fees.

After 30 days, it will be reported to the credit bureaus as past due.

90 to 120 days past due: Collections – Internal or Third-Party

Calls and letters might increase. With a third party collector you have the right to send a cease contact letter to stop harassing calls. This does not end responsibility of owing the debt, and repossession could begin.

If affordable, this is the final opportunity to bring past due debts into good standing and help preserve your credit.

120 to 180 days past due: Charge Off or Repossession May Occur

The debt is charged off and reported as uncollectable with the original creditor. You still owe the money, and collection efforts continue. For secured loans, the item might be repossessed (taken back by the lender.) *See car loan section below*.

Charge off/repossession status can remain on credit report for seven years from date of last payment.

More than 180 days past due: Court Action and Judgments are Possible

The debt collector might go to court for a judgment. If a judgment is obtained, the result might be a garnishment on wages or bank accounts, tax intercepts or a lien on property.

Depending on the situation, you may be eligible for an exemption for garnishment. This stage varies by state laws, and legal advice might be recommended.

Breaking It Down: Secured Debts

Mortgages

If you are struggling with your mortgage payments, call your lender to find out what options are available. Get statements and arrangements in writing, or document who you spoke with.

- If **forbearance** is available (where you can skip payments), ask how that will be reported on the credit report and what happens with the missed payments after the forbearance is done.
- As stressful as your situation may be, don't yell or argue with them, as that may escalate things faster than intended.
- Continue to set aside as much money as you can in the meantime.

Find a HUD-approved counseling agency near you:
apps.hud.gov/offices/hsg/sfh/hcc/fc/index.cfm.

Please call them especially if you receive a pre-foreclosure or sheriff's sale notice. The Department of Housing and Urban Development (HUD) has created a network of HUD-certified housing counselors. They can give you information on what your options are and help you understand more about your loan and the foreclosure process in your state.

Car Loans

If you are struggling with your car payments, call your lender to find out what options are available.

- If **forbearance** is available (where you can skip payments), ask how that will be reported on the credit report and what happens with the missed payments after the forbearance is done.
- Refer to debt timeline. Please note repossession may start as soon as 90 days past due; however, it is in your best interest to call your lender first to work out a payment arrangement.
- **Repossession** is when the lender takes back the vehicle and sells it. The amount it was sold for is applied to the loan balance. Depending on the situation, there may be a remaining balance.
- Review your loan contract to see if any remaining balance needs to be paid or if it will be written off by the lender. If you need to pay it back, you can set up payment arrangements. At this point, it becomes an unsecured debt.

Breaking It Down: Government Debts

Federal Student Loans

Issued by the federal government and regulated by federal law, these loans provide many rights and protections for the borrower. There have been many federal student loans programs in the past, but the only federal student loans issued now are from the William D. Ford Direct Loan Program (direct loans). Once your loans are disbursed, you are assigned a separate loan servicer for your needs and payments. Go to studentaid.gov for helpful information and your complete list of federal student loans.

Key Terms:

- **Grace Period:** A short break, generally six months, before you start repayments after you graduate, leave school or drop below half-time enrollment.
- **Deferment:** Time off from making payments – happens automatically while in school at least half-time. Additional periods of deferment available for economic hardship, military service, etc.
- **Forbearance:** Additional voluntary time off from making payments for a limited time.
- **Capitalization:** When the unpaid interest on the loan is added to the loan balance after deferment or forbearance. Going forward, new interest will be charged on the higher balance amount.
- **Subsidized Loans:** Available to undergraduate students with financial need. The government pays the interest on these loans while you are in school or qualified deferment, so the balance will not increase by the time you graduate or the deferment period ends.
- **Unsubsidized Loans:** Available to undergraduate and graduate students with no needs-based restrictions. Interest starts accruing once the loan is dispersed, and if left unpaid will end up being added to the overall balance **(capitalization)**. By the time you graduate or end a deferment or forbearance, the balance will have increased.
- **Parent PLUS Loans:** Student loans issued directly to parents to help pay for child's education costs. Credit checks are required. Payments for Parent PLUS loans begin **once the loan is dispersed,** NOT when the student is finished with school. Deferment options are available.

Find out what you owe and avoid forbearance:

- Be prepared to make payments. A budget is helpful to make sure it is affordable long term. Use the calculator at finaid.org to figure out your future payments.
- Explore Income-Driven Repayment (IDR) options for federal loans if standard payments are unaffordable. It is based on your income and can sometimes be paired with loan forgiveness. Get specifics at studentloanborrowerassistance.org or studentaid.gov.
- While you are enrolled in higher education, the loans are in deferment. Similarly, after you graduate or leave school and the grace period has ended, you can apply for forbearance so there is no monthly payment right away. However, since interest charges still accrue on most loan types and there are time limits on how long you can defer, this is a temporary solution. Deferment and forbearance periods do not count towards loan forgiveness, so setting up affordable payments is encouraged.

Breaking It Down: Government Debts

Do not default on your loans, but if it happens:

- After 270 days of non-payment, the loans will go into default. Collectors can add huge fees garnish your paycheck and intercept your tax refunds affecting your credit for a long time.
- You have only two chances for the life of the loan to bring them back into good standing – rehabilitation or consolidation.
- Seek out help with a trusted National Foundation for Credit Counseling (NFCC) agency (*see credit card section*). They can walk you through your options based on your situation.

Explore forgiveness options:

- **Public Service Loan Forgiveness (PSLF):** PSLF generally requires 120 payments (10 years) of income-based repayment while working in government or qualifying non-profit jobs. Once the requirements are met, the remaining loan balance is forgiven, tax-free. Rules are ever-changing, so keep up to date here: studentaid.gov/pslf.
- **Total and Permanent Disability (TPD) Discharge:** If you qualify and you do not plan to go to school in the future, the loan amount forgiven is tax-free. Visit disabilitydischarge.com.
- **Paying Income-Driven Repayment (IDR) Plans for 20 or 25 Years:** After you have paid for 20 or 25 years (depending on the loan type), the remaining loan balance will be forgiven. However, the forgiven debt may be considered taxable income after 2025, so plan accordingly.

SCAM ALERT: Scammers will send letters or emails offering "quick forgiveness" or "free" assistance with forms, but they end up charging a large upfront or ongoing monthly fee. You do not have to pay fees to get access to these forms. All repayment, default and forgiveness programs for federal loans are available through the Department of Education for free, and there is no such way to pay to get your loans forgiven faster. Some NFCC counseling agencies offer free student loan counseling.

A Quick Word on Refinancing: Be wary of refinancing federal student loans into private student loans. When interest rates are low, and your credit is good, private loans may have lower rates than federal student loans. It may be tempting to refinance your federal loans with private student loans instead. If you refinance to a private loan, you will be losing the protections, payment options and forgiveness programs that federal loans provide.

Breaking It Down: Government Debts

Income Tax Debt

It is important to file your taxes even if you are going to owe money and can't pay.

If you don't file, the government will charge extra penalties, making it worse. They will charge you interest on any tax owed if not paid by the filing deadline, but the rates are not as high as many other debts you might have. You can file for an extension, but interest and penalties still accrue.

Set up a payment plan.

The IRS and state revenue departments would prefer the debt paid off within 180 days, but you can arrange a long-term payment plan. Whenever possible, pay more when you can to save on interest, but do not over-promise and then fall off the plan. Be sure to keep up with payments, make sure the current tax withholding is accurate going forward, and claim your tax credits to help reduce any tax debt owed.

If a regular payment plan is not realistic, you can explore an Offer in Compromise, which allows you to settle your tax debt for less than the full amount. According to the IRS,

> "It may be a legitimate option if you can't pay your full tax liability, or doing so creates a financial hardship. We consider your unique set of facts and circumstances: ability to pay, income, expenses and asset equity.
>
> We generally approve an offer in compromise when the amount offered represents the most we can expect to collect within a reasonable period. Explore all other payment options before submitting an offer in compromise. The Offer in Compromise program is not for everyone. If you hire a tax professional to help you file an offer, be sure to check his or her qualifications."[1]

Utilize the IRS taxpayer assistance center or your state's taxpayer rights advocate.

If you have been unable to resolve your issues on your own or need additional assistance, the IRS and your state each have a service which can help for free. They may also help in more complicated situations. For example, your now-deceased spouse may have filed a fraudulent return or hidden income, or you became unable to work due to a serious disability. Visit: irs.gov/help/tac-locations-where-in-person-document-verification-is-provided.

There are consequences for not paying the state and federal government.

If you do not pay your taxes, the IRS and your state Department of Revenue can impose a wide range of penalties, including garnishing your wages, pensions, and government income like Social Security; intercepting your tax refunds; and seizing and selling your property. They also can collect for other government debts, such as an unpaid county medical center bill, overpayment of benefits paid to unemployment or welfare, back-owed child support or defaulted student loans.

Avoid heavily advertised "tax-relief" companies that charge high fees (i.e. – thousands of dollars), and instead use the federal and state advocates for free.

1 https://www.irs.gov/payments/offer-in-compromise

Breaking It Down: Unsecured Debts

Credit Cards

Credit cards are a tool that allow you to borrow money and pay it back later.

The credit card company (also known as a creditor) approves a credit limit – the maximum amount you can spend. This is a **revolving debt** – the amount available to borrow changes as you pay down debt or charge more. The creditor might change your credit limit and interest rates based on your circumstances. For example, if you pay on time and your income increases, your credit limit might go up and your interest rate might go down. However, if you miss one or more payments, the creditor could raise your rates and lower your credit limit. The creditor can also charge fees if you are late or charge more than the limit.

A grace period is given as an opportunity to pay off the full amount charged without paying any interest. The average grace period is 25 or more days. For example, if the closing date is February 8, you would pay the total amount charged by March 5 to avoid interest. That's how your statement balance is calculated. This information can be found if you have an online account or through a phone app with the creditor.

Payment due date	Mar 05, 2021
Minimum payment due	$35.00
Statement balance (as of Feb 08)	$2,841.41
Current balance	$3,156.41
Next closing date	Mar 08, 2021

If you pay the statement balance every month in full by the due date, then you do not have to worry about paying interest. Credit cards can be a helpful tool in building good credit history, providing added protections when renting a car or buying items online and earning rewards (e.g., airline miles and cash back) on items you would normally buy.

Note on Debit Cards: While it has the logo and the 16-digit number, a debit card is NOT a credit card. It is a way to pay for items using the money you have in your bank account.

- Pros: Convenient, helps break the habit of using credit cards, does not create debt, can use at an ATM to get cash.
- Cons: Could overdraw account resulting in fees, does not build credit, may have extra holds on funds when used for car or hotel room rentals, less protections for fraud.

Be careful – debit card use needs to be treated like cash and tracked accordingly for budgeting. If the card is stolen or used fraudulently, this could create larger problems by not being able to pay your priority bills, as it might take a long time to get the money back, if at all. (*See Cornerstone Four.*)

Minimum Payments and Compound Interest: A Dangerous Combination

At first glance, credit cards seem like a great opportunity. You may be in a store and the employee will say, "Do you want to apply for a card today and get an extra 20% off?" Sure, why not!

Unfortunately, if you are not prepared to pay off the full amount charged by the next due date, it seems easier to make monthly payments instead. Creditors typically ask for 2% of the balance owed as a minimum payment. As a result, interest eats up that smaller payment. If you were to pay late, the added late fee will make the balance larger. The interest and fees then become part of the total balance, and more interest gets charged the next month – that is **compound interest**.

Breaking It Down: Unsecured Debts

Payment Schedule

Month	Minimum Payment	Interest Paid	Principal Paid	Remaining Balance
1	$40.00	$30.00	$10.00	$1,990.00
2	$39.80	$29.85	$9.95	$1,980.05
3	$39.60	$29.70	$9.90	$1,970.15
4	$39.40	$29.55	$9.85	$1,960.30
5	$39.21	$29.40	$9.81	$1,950.50
6	$39.01	$29.26	$9.75	$1,940.75
7	$38.81	$29.11	$9.70	$1,931.05

Example: $2,000 is charged at 18%, and the minimum payment is $40. As the balance slowly gets smaller, so does the payment. It may not look like a big deal, but it would take 289 months to pay the credit card off!

Paying more pays off the debt much faster. Even keeping it at a fixed $40 per month (the original minimum payment) pays this off in 94 months.

Credit Card Payment Strategies for Success

Paying the Debt Off on Your Own: If you can afford to pay more than the minimums, this is a good way to start.

1. Figure out how much extra you can pay on your credit card debt each month.
2. Call the creditors directly to see if they would reduce your interest rates.
3. Create your "Debt Snowball Plan" – pay off your debt from smallest to largest balance.
4. List all your debts accordingly.
5. Pay minimum payments on every debt EXCEPT the smallest balance.
6. Put the extra money towards the smallest debt. Once one debt is paid off, roll the total paid to the next debt on the list, keeping the total monthly debt payment the same until all are paid off.

	Balance	Interest	Min. Pmt.	Extra $	Total Paid
1	$1,000	12.0%	$25	$25	$50
2	$2,500	15.9%	$50		$50
3	$3,000	8.9%	$60		$60
4	$5,000	23.9%	$110		$110
				Total monthly debt payment:	**$270**

	Balance	Interest	Min. Pmt.	Extra $	Total Paid
1	~~$1,000~~	~~12.0%~~	~~$25~~	~~$25~~	~~$50~~
2	$2,500	15.9%	$50	$50	$100
3	$3,000	8.9%	$60		$60
4	$5,000	23.9%	$110		$110
				Total monthly debt payment:	**$270**

Contact a Nonprofit Credit Counseling Agency for Support: If paying on your own is a struggle, find a nonprofit credit counseling agency that is a member of the National Foundation for Credit Counseling (NFCC). They have a tool that could be helpful called a **Debt Management Plan (DMP).**

The NFCC is a professional network which holds members to the highest standards. Member agencies must have certified financial counselors, offer free counseling and low-fee DMPs, and staff must be noncommission (meaning they do not profit from writing your DMP contract). They often provide counseling for budgeting and debt management, student loan repayment options and credit report reviews. Most agencies also have HUD-certified housing counselors.

Breaking It Down: Unsecured Debts

A Debt Management Plan (DMP): An agreement made between you and your creditors to pay off outstanding debts. You create a plan with a financial counselor, then make one payment to the counseling agency each month, and they send the funds to your creditors.

Payments for a DMP are typically lower than your current payments, and most creditors will significantly reduce interest rates and stop fees once you are on a DMP.

A Debt Management Plan will:

- Provide you an affordable payment plan and the simplicity of one payment.
- Typically lower your interest rates.
- Help you pay off your debt faster, in five years or less.
- Result in full repayment of your debts.
- Take the fear out of answering the phone and opening your mail.
- Include ongoing support from a dedicated support team and your financial counselor.

Beware of other "debt relief" services advertised on radio, TV, email and online. Many have been sued for fraud and client exploitation by charging high fees, not paying creditors as agreed, and trying to bait and switch customers into expensive consolidation loans or "debt settlement" scams, leading to unnecessary bankruptcies.

"Debt settlement" services are dangerous because they promise to get rid of your debt for less money. To do this, they typically advise you to stop paying your creditors, so your debts go into collections, making it easier to negotiate. At best, even if they make a few settlements, they charge thousands of dollars in fees, money that could have gone to your debts directly. (Plus, any debt forgiven over $600 is taxable income, which may create problems.) At worst, the service does nothing, leaving you with judgments and garnishments. By then, any positive credit you had will disappear and will take years to rebuild. Bottom line: If your debt is current, this is not the helpful solution you are looking for.[2]

Using Loans or Assets to Pay Off Unsecured Debt: Proceed with Caution

This should be approached carefully as these strategies may result in just shuffling the debt around instead of paying it off completely. Also, these options may not be available for everyone.

Loan Consolidation: Applying for a new loan to pay off existing unsecured debt might require using an asset as collateral to secure the loan, having a co-signer and/or good credit. You risk losing the asset or having your co-signer's credit negatively impacted if payments are missed. Unsecured loans tend to have much higher interest rates like credit cards, so it might not save you any money.

- If using the home as collateral, equity will be reduced, so if you have an emergency repair, it's not available to help maintain the value of the property.
- You lose the option to discharge unsecured debt in a bankruptcy once it's a secured loan.
- Taking a loan to pay off debt is often a band-aid without budgeting, resulting in more debt.

Using Retirement Funds: Taking loans or withdrawals from retirement plans sounds like a fast solution, but that can deplete the growth of your retirement savings, which robs from your future self.

- Loans from employer plans will lower your net pay, since they are repaid from every paycheck.
- If you ever leave the job or are laid off, the whole loan becomes due immediately.
- Withdrawals are taxed 20% or more PLUS 10% penalty, so taking $1,000 may only get you $600.
- If that money was left alone in retirement investments, that $1,000 could grow to much more.

2 https://www.ag.state.mn.us/consumer/publications/debtassistancescams.asp

Medical Bills

Medical debt is special in that it is not really a consumer purchase but more an essential item, and every provider seems to have different rules. Unfortunately, as smaller medical providers merge with larger ones, billing is more centralized and even being outsourced to a third-party agency. Dealing with medical debt is not as easy as it used to be, and many times it goes to collections much faster.

Open Your Mail	Keep your medical bills organized in one spot. Highlight or circle the billing office number to keep track of what bills go together so you can make plans for a bunch of them at a time.
Review Your Bills	Make sure everything is billed correctly regarding your out-of-pocket deductible and maximum. Ask for an itemized bill. Contact your insurance company if something was not covered. Make sure it is corrected.
Call Every Different Billing Office	Check if you qualify for financial assistance, especially if income has been reduced. There might be a separate application you need to fill out and sign with documentation needed. (Also called community or charity care.)
Set Up Payments Arrangements	Set up payment arrangements on the remaining amount owed. The billing office may have a strict set of rules, so make sure that the payments are realistic and affordable for you. Get the agreement in writing if possible.
Keep Track and Proof of Payments	Keep all proof of payments for your records. Setting up a payment plan may prevent them from trying to sell it to a collector, but it is not guaranteed. The faster you can pay them off, the better.
Call Again for Each New Bill	You'll need to repeat the process each time for each new bill. Do not assume it will be done automatically.

Collections

Repaying Collections in Full

Collections could be from various unpaid debts – credit cards, medical bills, various lenders, etc. Based off the Debt Timeline above, there are different stages of collections:

Past Due But Not Charged Off: You are still getting the original statements and can log in to your account normally. Make plans to bring it back into current status quickly, possibly making a partial payment to avoid further collections.

Charged Off and with a Collector: You don't have contact with the original creditor and have a statement from the collector showing the balance owed with payment arrangement offers. If affordable, pay as quickly as possible (especially if it is not on the credit report). If not affordable, keep the statement for future payoff.

Collection Debt May Be Several Years Old: Pull your credit reports from annualcreditreport.com to see if it's reported and how old it is. Find out whether the statute of limitations has passed – check with your state Attorney General's Office at naag.org.

Watch for Court Summons: Open the mail and respond to any court papers regarding a judgment. Some will ask you to respond in writing within a time frame (do it and keep a copy). Some will summon you to appear in court on a given date and time (do it and bring papers showing your payment plan has already started). If you do not do what is asked, you will lose by default and have legal costs added to your debt.

Protections from Garnishment

Once a judgment is obtained, creditors have the legal right to take money from your bank account or paycheck. You should get a notice of garnishment before this happens. However, certain wages may be protected from garnishment (**Minnesota only**):

- Amounts less than $290 per week.
- Social Security (SSA, SSDI, SSI) or other federal income (VA, Civil pensions, Railroad, etc.)
- Have direct deposit to a bank account that has less than two months worth of benefits.
- Needs-based assistance for medical needs, food support (SNAP/WIC), energy assistance, etc.
- Unemployment, workers' compensation, child support and insurance benefits.

Please note certain federal and county debts can collect on all types of income. Overall, protections vary state by state, but here are some general resources that can help:

- Federal Trade Commission: consumer.ftc.gov/articles/0114-garnishing-federal-benefits.
- Consumer Financial Protection Bureau: consumerfinance.gov/ask-cfpb/can-a-debtcollector-take-my-social-security-or-va-benefits-en-1157/.
- LawHelpMN: lawhelpmn.org/self-help-library/fact-sheet/garnishment-and-your-rights.

Collections

Repaying Collections in Full

If you want to pay off the debt in full but cannot afford to do so all at once, you have a few options:

- Set up a monthly payment plan either by phone or in writing.
- Save up the money first in a savings account, then arrange a lump sum payment. **Do not give them access to your main bank account**. Pay by money order by mail or prepaid card online.

By Phone: You can stay in control by calling them when you are ready to make payments. If you are not able to make payments, then do not answer when collectors call or engage in conversation. Making promises you can't keep might stop the calls for a while but will not make it better permanently.

When you call, be prepared with either an affordable monthly payment or the full amount to pay in one lump sum. Do NOT give them a payment by phone or give them access to your bank account. Get an agreement in writing before sending any money. Keep copies of payments as proof.

In Writing: If calling is not possible and you have the collector's contact information, sending a letter and payments shows that you are making efforts to repay. Receiving the letter or funds may not prevent collectors from doing anything they legally have the right to do, including charging fees, making collection calls or taking legal action. These actions are less likely to occur once they receive a letter about repayment intentions and see you follow through with the amounts promised.

Sample collection repayment plan letter:

> Date
>
> Debt Collector Company Name
>
> Debt Collector Company Address
>
> Dear Debt Collector:
>
> I am writing to you about my account #_________on which I owe $______. I intend to pay the whole debt but cannot pay it all at this time. I can pay $_______ each month and enclosed a check for this amount. You may contact me at the address below. Thank you for your understanding.
>
> Sincerely,
> Your Name and Address and Account Number

Instructions for repayment plan letter or mailing a payment:

1. Type the letter or print it very neatly and clearly, and do NOT include your phone number.
2. Mail your letter to the creditor/debt collector address listed on the most recent notice.
3. Send the repayment letter and funds certified mail (with a return receipt) to ensure receipt.
4. Keep a copy of the letter and any payments you send to a collector. It is common for monthly billing statements to stop being sent, so if legal action is taken you will have documentation showing your efforts.
5. Keep opening your mail. If you see a new/different collector has your account, send a new letter and pay accordingly. If you see any court orders for garnishments or judgments respond quickly, and if there is a court date make sure you are present with your payment evidence!

Collections

Debt Settlements: Do-It-Yourself Guide

Settlements can be an effective way to deal with collection debts. This is a plan where the collector is willing to accept less than the full balance owed as payment in full, and the account is updated to a zero balance. If the balances are larger, or if fees and interest have been added over time, a settlement can help pay off a few more debts at once when money is limited. There is no need for you to pay a company to arrange a settlement on your behalf. You can do it yourself – for free!

- Be sure to call the collector or attorney to confirm they still have the account first. It is not unusual for an account to be sold to different collection firms every three to six months.
- Negotiate the settlement amount, which may range from 20% to 80% of the balance.
- Be sure to get the settlement offer in writing before sending the payment and to keep all documentation for at least the next seven years in case problems or questions arise.
- Plan on paying one lump sum within the next thirty days. **Do not give them access to your main bank account**. Use a money order by mail or prepaid card online. Keep copies of your payment for your records.
- Keep good written notes on what is agreed to, including obtaining the representatives name and phone number with their extension and date of your conversation.
- The credit report(s) might show that a settlement was done. Check your credit reports 30 to 60 days after a settlement is completed to verify the unpaid balance is updated to zero.
- Any debt forgiven over $600 would be considered taxable income, which may result in additional taxes owed. Consult with a tax advisor as needed.

Sample Settlement Offer Letter: If calling is not possible, try it in writing.

> Date
>
> Collection Manager's Name
> ABC Collection Agency or Creditor Name
> Street Address
> City, State Zip Code
>
> Dear Collector:
>
> I am in financial difficulty now because (insert brief description here) and I am unable to make payments on my account. My income barely covers living expenses.
>
> I am committed to paying this debt and am willing to offer a settlement of (60) cents on the dollar as payment in full. My current balance is $ ($1,000). This lump sum payment in full of ($600) by can be made by (date). If you accept my offer, please send written confirmation to my address listed below.
>
> Sincerely, Your Name and Address.

Instructions:

1. Type the letter or print it very neatly and clearly, and do NOT include your phone number.
2. Mail your letter to the present and verified creditor/debt collector address.
3. Send the settlement offer letter and funds certified mail (with a return receipt).
4. Keep a copy of the letter and any payment(s) you send to a collector.

Collections

Your Rights Under the Fair Debt Collections Practices Act

This law regulates **third-party** debt collectors, prohibits “abusive and deceptive” practices and gives you these specific rights:

- Collectors must not call after 9 p.m. or before 8 a.m. and must identify themselves.
- Collectors must not use obscene language nor tell the nature of the debts to others.
- Collectors must not list false information on a credit report nor make a threat of violence.
- Collectors must stop all contact in any way you request (i.e.– no calls at work or home).
- Collectors must provide written verification of the debt within 30 days of your request.

That final right is important when dealing with **debt buyers**. Old debts are often sold, like property, from debt collector to debt collector, and in many cases with no original paperwork or proof of the debt – just an electronic list of names and amounts owed. Debt buyers have been caught trying to collect the same debt over and over from people with similar names. If you get a call stating that you owe an old debt, your best step is to say, “I need you to send me verification of this debt in writing.” Once you ask for this proof of debt, they are required to stop collections until they provide it – and in many cases they don’t have any of the original proof.

If you experience debt collectors doing any of the forbidden practices, contact the state Attorney General office to file a complaint. You can also contact a lawyer who specializes in violations of the Fair Debt Collection Practices Act (FDCPA) through the National Association of Consumer Advocates (NACA): consumeradvocates.org. NACA attorneys charge no fees to consumers and can hold collectors accountable to the law.

What Is Bankruptcy?

Bankruptcy is a court proceeding where you may file **Chapter 7** to erase all unsecured debts, or **Chapter 13**, where a court-run payment plan pays back some debt, but erases the rest. It is complex, so get a free consultation from a bankruptcy attorney and ask a lot of questions. Bankruptcy is expensive, as Chapter 7 requires all legal fees be paid up front. Chapter 13 legal fees can be paid on a monthly basis, but the overall cost could end up being **three times** higher. Consider the consequences of filing bankruptcy to make an informed decision:

- It is a public record and on your credit report for up to 10 years, which can affect future employment, renting and increased interest rates on future loans.
- Without fixing the initial problem (unemployment or reduced income, high medical bills, not stopping debt use, struggles with substance abuse or gambling, etc.), many people find themselves in a similar situation a few years later.

However, bankruptcy can be used as a tool to rebuild and move forward – sometimes things happen beyond our control. Being able to meet daily needs is the main priority, especially if paying back the debts is no longer realistic or legal action has been taken like a garnishment. There are times where good money has been thrown at bad debts to avoid bankruptcy, only to file later. It’s important to know that it might be appropriate to seek legal help to clear out debts.

Private Student Loans

Private student loans require a credit check and often require co-signers. Various lenders offer student loans, and you apply for them individually like
you would other loans. Keep in mind that private loans have fewer options should payments become unaffordable down the road.

Grace periods and deferment options vary by lender. There is no standard and will depend on your loan terms, similar to other types of unsecured debt. You can refinance private student loans to lower interest rates if your credit is in good standing.

- If you are struggling with your current payments, call the loan servicer to find out your options.
- To find defaulted private student loans, check your credit reports.

Other Unsecured Loan Products

These types of loans are used for a variety of reasons – emergencies, paying off other debts or buying things that cannot be paid for outright. Many times, this type of debt focuses only on the monthly payment to distract us from the overall cost of the loan. If you can't afford the item you want in full, it would be better to try to save for a while instead.

Buy Now, Pay Later

This is a newer trend due to the increase of online shopping. Buy Now, Pay Later (BNPL) is a way to purchase an item and then split the cost into equal installments (usually four) over a short time frame of around 12 weeks or less, interest-free.

Pros: If you pay on time and in full, there are no costs. Many times, no credit check is required, but they still report to the credit bureaus. This could affect you positively or negatively depending on your payment history.

Cons: If you do not pay off the debt within the short time frame or pay late, you will be liable for fees and interest that can exceed a normal credit card. It also encourages impulse buying of things you might not need.

In studies[3] and surveys[4] done in 2020:

- 42% of Gen Z and 69% of millennials are more likely to purchase items if BNPL is offered.
- Nearly half of consumers spend 10% to over 40% more with BNPL vs. a credit card.
- 66% said they are buying jewelry and other "want" items that they might not otherwise get.

Rent-to-Own Plans

These businesses allow you to take home appliances, furniture, electronics and tires; then you pay them on a weekly or monthly basis. No credit check is required, but they report to the credit bureaus. For some who cannot buy items in cash or with traditional credit, this might be helpful and not as expensive if paid off in a short amount of time. However, the small payments encourage impulse buying, and the total amount paid can be up to two times (or more!) the original cost. If you stop making payments, they might repossess the items and charge you fees. These stores are regulated state by state, and some have stronger laws against predatory practices.

3 https://www.fool.com/the-ascent/research/buy-now-pay-later-statistics/
4 https://www.cardify.ai/reports/buy-now-pay-later

Other Unsecured Loan Products

Ultra HD TV		
	Payments	**Total Paid**
SD - 50”	$50/mo for 24 months	**$1,199**
MN - 55”	$17.93/wk for 46 weeks	**$825**
RETAIL - 65”	Save $50/mo for 9 months	**$469**

Standard Dryer		
	Payments	**Total Paid**
SD	$40/mo for 24 months	**$960**
MN	$16.42/wk for 37 weeks	**$608**
RETAIL	Save $50/mo for 9 months	**$449**

Compare the prices between South Dakota and Minnesota: The cheapest option is saving first and paying for it later. So, if you can avoid rent-to-own, please do.

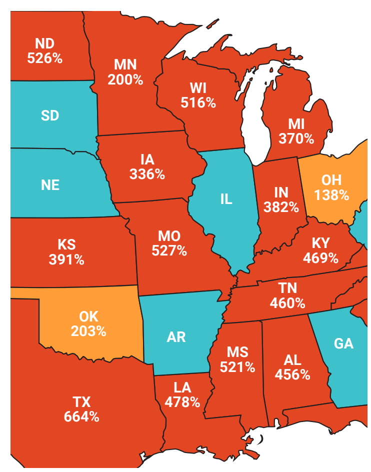
If you already have them, continue to make on-time payments, adding extra as affordable.

Payday Loans

Payday loans are a way to borrow cash for a short-term period. They are generally structured to be repaid in full, including fees, on the same schedule as you receive a paycheck (hence the name). You do not need to pledge any assets, and no credit check is required, but they do NOT report payment history to the credit bureaus. However, you must have a bank account (or prepaid card) and proof of income.

How they normally work:[5] You borrow $400 for an emergency. The lender charges a $60 fee and wants to be paid back in two weeks. You pay them $460. That’s an equivalent interest rate of **391%**!

The reality of payday loans is that most are being used for daily living, so many people cannot pay off the loan the first time. They end up re-upping the loan (paying just the fee) or taking out **additional loans** to pay off the old ones. **This can lead to a cycle of debt that is hard to break**.



Title Loans are like payday loans except you pledge your vehicle’s title to get the loan. These loans are typically larger and paid off with monthly payments. The annual percentage rate (APR) is just as high, and if you miss just one payment, you could lose your vehicle. Title loans are dangerous and should be avoided.

States regulate payday and title loans, and some have outlawed payday and/or title loans completely.[6] Other states have a payday loan rate cap of 36% or lower. Military members have been protected from these loans through federal law. Unfortunately, the increase of online lenders has made regulation more difficult. The Consumer Financial Protection Bureau (CFPB) has the potential to help on a federal level, as well as potential federal laws to protect consumers nationwide.

Personal Loans (Also Known as Consolidation Loans)

Finance companies or peer-to-peer (P2P) lenders offer this type of loan, commonly online. These loans are unsecured (no collateral), often no credit check is required and most will report payment history to the credit bureaus. As a result, interest rates might be as high as 36% to 99% (or more!), much higher than banks or credit unions. Research the total APR, fees, terms and payment schedule, and compare to other options. When under large amounts of stress, it might seem fast and easy to get a loan in the moment. Unfortunately, some of these loans are tricky, and the payments might go up over time. Or, there are pre-payment penalties which make it expensive. There is little negotiation to get reduced interest rates or a modified payment plan like there are with credit cards.

5 https://research.stlouisfed.org/publications/page1-econ/2019/04/10/fast-cash-and-payday-loans
6 https://www.responsiblelending.org/research-publication/map-us-payday-interest-rates (shows the full map)

The Importance of Asset Building

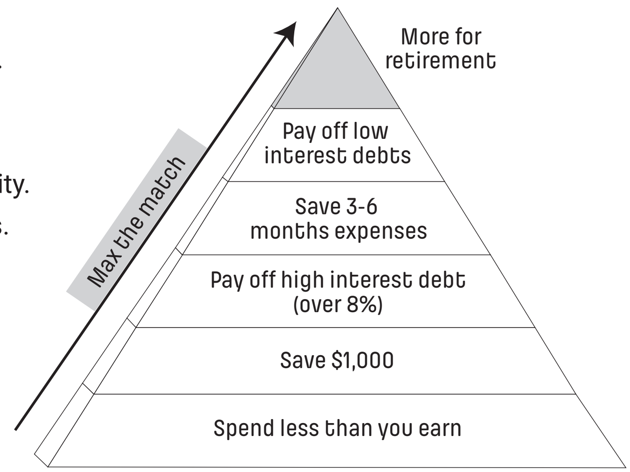
An asset is something you own that has lasting or growing value. Assets are different from income. You could have a great income, but it could disappear if you lose your job or are unable to work. **Assets are how you achieve wealth accumulation**. There are certain assets that can help make life affordable, as well as long-term assets that can generate future income when you retire.

Assets include:

- Savings, like bank accounts and U.S. savings bonds.
- Real estate, like house and land.
- Investments, like stocks, bonds and mutual funds.
- Retirement funds, like 401Ks, IRAs and Social Security.
- Valuable items, like art, jewelry and paid-off vehicles.

While overall wealth can be more than just money, in this context, wealth accumulation is building up your **net worth** over time.

The Pyramid of Financial Wellness



Understanding Net Worth
Assets - Liabilities = Net Worth

First, add up all assets by calculating its value.

Savings	$2,000
401k	$15,000
Car	$8,000
Total:	**$25,000**

Then, add up all the debt owed (liabilites).

Credit cards	$6,000
Student loans	$25,000
Car loan	$10,000
Total:	**$41,000**

Assets: $25,000 minus
Liabilities: $41,000
= **$-16,000 Net Worth**

This example's net worth is a negative amount. This can be a common situation. If loans are needed for higher education, extra debt is taken out or the value of the vehicle ends up lower than the loan amount, one may end up with negative equity overall. Now, let's say you work on paying off the credit cards and the car loan. Now the car is worth $5,000 and the 401k has grown by $7,000. Look!

First, add up all assets by calculating its value.

Savings	$2,000	
401k	~~$15,000~~	$22,000
Car	~~$8,000~~	$5,000
Total:	**$29,000**	

Then, add up all the debt owed (liabilites).

Credit cards	~~$6,000~~	$0!
Student loans	$25,000	
Car loan	~~$10,000~~	$0!
Total:	**$25,000**	

Assets: $29,000 minus
Liabilities: $25,000
= **$4,000 Net Worth**

Building wealth and financial stability cannot rely on income alone – since income can be lost or reduced. You'll therefore want to build financial assets through saving and investing to have a positive net worth. Budgeting is important AND equally important is access through opportunities that increase your net worth over time. When making decisions, a good question to ask may be: **Will this increase or decrease my overall net worth?**

For People of Islamic Faith Who Avoid Earning Interest: We want to acknowledge that American financial systems are based on interest-bearing products, so our focus is on those types and how they work. However, there are alternative ways of investing and qualified professionals that specialize in those options. Contact your local Islamic Resource Center for resources.

Interpersonal Assets and Community Resources

Interpersonal assets allow us to continue to build personal wealth. They are not physical in nature, but still hold value. For individuals it may be reputation,education or a business partnership, while businesses have name recognition, trademarks or patents. This also includes helping a friend out and receivingother non-cash benefits in return; for example, home or car repairs, transportation, food, etc.

Communities also provide an important network of goods and services. Local government, community organizers and advocates, social service agencies, nonprofits, religious organizations, community-based financial institutions and small business owners all contribute to a framework that help support sustainable living and affordable housing.

Overall, community investments are valuable because when individuals thrive, the community is raised up and strengthened in return.

Exercise:

Identify your interpersonal assets.

How do they help you?

How do you help others?

Exercise:

Identify your community resources.

What works well?

Where are there gaps?

Social Security: Will I Receive a Monthly Benefit?

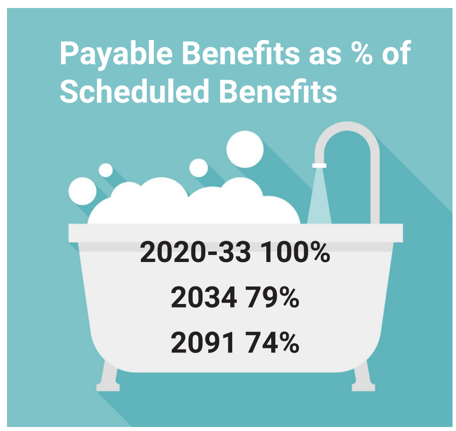
There has always been fear that Social Security will not be there by the time you retire. But studies show that it will last, and if you have been working, this should be part of your long-term retirement planning.

You pay into the Social Security Trust Fund through your paycheck (FICA), and employers match this amount. The more years you work, the higher benefit you get when you retire – but you must work at least 40 credits (10 years of full-time work) in order to qualify when you retire. The medical insurance provided along with Social Security is Medicare, and there are also benefits paid to survivors (if you died) or in case of disability (if you are unable to work).

Think of it like a bathtub.[7] The Social Security Trust is the level of water in the tub, and while there are workers contributing, there is water going into the tub. However, the drain is open, and the water is flowing to those who are retired. The concern about Social Security is that the level of the water is going to be lower over time if nothing is done to change it.

Based on current contribution rates:

- Those retiring between now and 2033 will have 100% of their benefits.
- Those retiring in 2034 will be paid out 79% of their scheduled benefits.
- There is not another projected reduction in benefits until 2091 – people are either babies or not even born yet!



To find out more information on your Social Security benefits, create an online account at ssa.gov. You'll be able to review your earnings history, retirement benefit and potential disability income. This can be a helpful tool for planning purposes.

7 Source: Social Security Trustees Report 2020, https://www.ssa.gov/oact/tr/2020/

Investments: An Effective Way to Build Future Income

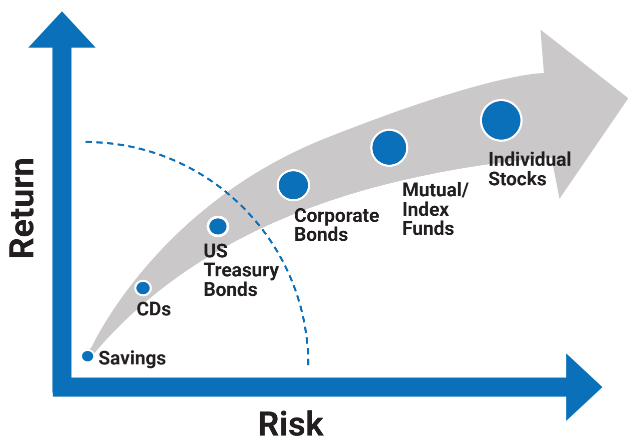
Compound interest is your friend when it comes to investments. It allows your money to grow at a much faster rate over time due to the interest earning interest.

Year 1	Year 2	Year 3	Year 15
$10,000 invested, 5% rate of return: **$500 earned**	$10,500 invested, 5% rate of return: **$525 earned**	$11,025 invested, 5% rate of return: **$551 earned**	**$19,799 invested,** 5% rate of return: **$990 earned**

The Rule of 72 is an easy way to show how long it will take to double your money in an investment. Divide the number 72 by the annual rate of return for your investment. That is how many years it will take. Using the example above: 72 / 5% = 14.4 years.

This helps you decide how risky you'd like to invest and show how much you might have for college or retirement in the future with your current savings. It might motivate you to start saving for retirement or increase your current contributions.

There are many ways to invest money, and all of them involve the **risk-return tradeoff.** You will get paid a higher rate of growth and interest in return for taking more risks.



Everything to the left of the dotted line is insured by FDIC or NCUA.

Market Risk	The chance that the stocks or bonds you invest in will decline in value.
Inflation Risk	The chance your savings will not keep up with rising costs of living.
Interest Rate Risk	The chance that your savings will lose value if interest rates rise.
Liquidity Risk	The chance that you will need your money before it is available.

All investments (or non-investments) have risk involved:

- Savings accounts have inflation risk because prices may rise faster than the interest rate paid.
- Bonds have interest rate risk because the value of your bond decreases if interest rates rise.
- Certificates of Deposit (CD) have liquidity risk since if you take your money before the term is up, you will have to pay a penalty. Savings bonds also pay only if you lock in the money.
- Stocks have market risk because the companies can go down in value or go out of business.
- Real estate has liquidity and market risks because it takes a while to sell, costs interest to borrow equity, and property value may fluctuate depending on the economy.
- Keeping your money under the mattress is the highest risk of all – getting stolen or destroyed, and never keeping up with the increased costs of living from inflation.

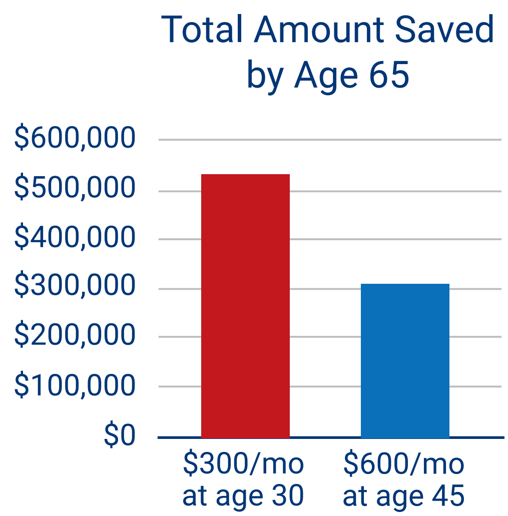
Investments: An Effective Way to Build Future Income

Strategies to Keep Risks Low and Returns High

Diversification
If you put all your eggs into one basket, they could all get broken. One way to diversify is to buy some of each type of investment. Another is to buy mutual funds, which pool the money of many investors to buy a lot of different stocks. Buying a single stock is like betting on one horse to win a race. Buying a stock mutual fund is like betting on **multiple** horses in the race.

Keep Costs Low
Compare the expense ratios, transaction and management fees with your fund choices. Some investment firms will let you buy mutual funds with as little as $100 and low to no costs to keep the account open. By keeping costs low, more of your money goes toward owning more shares and earning
the rate of return.

Start Early and Keep Going
The more time you keep your savings working for you, the faster they grow. For example, if you started at age 30 investing $300 per month into mutual funds that earned 7% per year, you would have $540,316 by the time you retire at age 65. But if you waited until age 45, and then even put twice as much in ($600 per month), at the same 7% rate, you would only have $312,556 by age 65. Slow and steady wins the race for long-term investing.



Dollar Cost Averaging
The popular advice with investments is to “buy low and sell high.” Unfortunately, it is impossible to predict that. Dollar cost averaging spreads out risk by investing a smaller fixed amount monthly as opposed to a large lump sum at once. This allows you to invest throughout the year, reducing volatility. If you participate in an employer retirement plan or invest monthly, you are using this strategy.

Buy and Hold, Rather than Chase “Hot” Investments
People often make mistakes based on greed and fear. They chase the hot new stock they heard about (greed), and they dump good stocks that have a down year (fear). Use your head and know that there are ups and downs. Don’t waste a lot of time and money on transaction fees by selling and buying in a panic. Investing should be as boring as watching grass grow. Slow and steady.

What If I Want to Chase “Hot” Investments
There are online communities that encourage people to invest in penny stocks (companies that are doing very poorly) or “undervalued” companies with the hope that any increase in value will make fast money. This is essentially gambling and can be just as addicting. While it is highly recommended to avoid completely, if you decide to do it, treat it just like you would anything else – only use money you can afford to lose, and don’t take on debt to fund it.

Investments: An Effective Way to Build Future Income

Retirement Accounts: Common Ways to Invest

Max the Match with Employer Plans (401k, 403b, 457)

Some employers offer retirement plans that employees can contribute to directly pre-tax and the account is tax-deferred, meaning there are no taxes on what you put in or the growth over time. You pay taxes on what you take out at retirement, which is usually any time after age 59 ½. Typically, there is a penalty if you withdraw before that time. The nice part of employer retirement plans is that it is easy to set up contributions from your paycheck and might not affect your net income too much.

It's a huge benefit **when employers offer a match for what you put in.** Contribute up to the match to maximize the most money available to you.

- Why? It's **additional free money!**
- Some employers will contribute a fixed amount regardless if you contribute.
- This helps your overall account grow faster over time.
- Review your options so you do not leave money behind.

It adds up! Let's compare keeping $100 per month versus contributing to a retirement plan with a 50% match. By putting it aside for later, you can save **twice as much!**

Spend It Now:

- Take the $100.
- Minus taxes ($30).
- You have **$70**.

Put It Into a 401K with a Match:

- Save the $100 in a 401K.
- No taxes, 100% invested.
- Employer matches 50%: **$150 invested**.

Employer contributions may need to be **vested,** which means that you must work for them for a certain amount of years before being able to keep those funds. To find that information, you'd need to refer to your benefit guidelines. Your contributions are always immediately vested, so if you were to leave your current job and go to a different one, 100% of that money is yours.

Pensions: Some employers offer a pension plan that will pay you a monthly amount when you retire. Most require you to work a certain number of years before you qualify for any benefit. In the meantime, you might still have the ability the contribute to a separate retirement plan on your own, which is recommended, especially if you won't stay long enough to receive the pension.

Investments: An Effective Way to Build Future Income

Individual Retirement Accounts (IRA and ROTH IRA, Self-Employed)

Anyone can open a Roth or Traditional IRA regardless of employment status by using a financial institution or an investment firm. If you are self-employed, you have your own account options.

Roth IRA
Post-tax contributions; tax free upon withdrawal

Individual account
Has annual contribution limit with catch-up amount after age 50

Can withdraw contributions without tax or penalty, but not earnings

Traditional IRA
Tax-deductible contributions; taxable upon withdrawal

Individual account
Has annual contribution limit with catch-up amount after age 50

Penalty taxes paid on early withdrawals (before age 59½)

SEP IRA
Pre-tax contributions; taxable upon withdrawal

Employer Provided
Employer only contributes to account

Mainly for businesses with fewer than 100 employees

SIMPLE IRA
Pre-tax contributions; taxable upon withdrawal

Employer Provided
Employer and employee contribute

Any size business

You put money in one of these options, and it grows tax-free until you start to take it at retirement (no penalties after 59 ½). If you don't take money out right away, you might be forced to take the **required minimum distribution (RMD)**. The RMD is an amount that U.S. tax law requires you to withdraw annually at age 72 from Traditional, SEP and SIMPLE IRAs as well as your employer retirement plan. (You know the old trope of death and taxes. You can't hide your money forever!)

Finding a Financial Planner

Trust is imperative to the relationship!

Interview the professional in person (or a few).

Make sure you are working with a Certified Financial Planner (CFP).

Find out how they are paid: Commission, Fee Only or Commission and fees.

Always ask for a written disclosure document (financial planning document or Form ADV).

Go to plannersearch.org to learn more.

Check to make sure there are no disciplinary actions filed:

- **Investment advisors:** adviserinfo.sec.gov.
- **Businesses:** bbb.org.
- **Security agents, Stockbrokers:** brokercheck.finra.org.
- **CFP® professionals:** cfp.net.
- **Insurance agents:** Your state's insurance commission or department of commerce

Helpful Tips:

- Ensure your financial planner has **fiduciary responsibility,** which means they must keep your best interests in mind.
- Ask for a disclosure of other business relationships that might affect their advice.
- It might take a few tries to find a planner or advisor you like. That is okay!

Homeownership as a Way to Build Wealth

Owning a home can be one way to build wealth, because the general idea is that the home becomes worth more than what you paid for it. The equity you own in a home is value of the home minus the mortgage loan, so each monthly payment you make builds a little bit more equity for you. The goal is to pay off the mortgage at some point so it reduces your overall expenses in retirement. Some people can sell their home and downsize to a less expensive home, which allows them to “cash in” the equity.

Unfortunately, many Black, Indigenous and people of color (BIPOC) and other ethnic groups have historically been shut out of this wealth building opportunity through discriminatory lending practices and policies, redlining neighborhoods, and racial covenants banning the sale of homes to specific races and ethnicities. These practices have been made illegal, but discrimination still exists.

Homeownership is a big commitment, so it’s important to be aware of the pros and cons. If and when you feel ready to pursue this goal, here are some things to consider:

Advantages:

- Feeling a Sense of Ownership: Security and stability in where you live.
- Stable Housing Costs: Same payment every month, unlike rent that goes up.
- Increased Net Worth: If the value is higher when you sell, you make a profit.
- Potential tax benefits and property tax refunds, depending on the state.

Disadvantages:

- Increased Financial Responsibility: Insurance, property taxes, repairs, etc.
- Requires Long-Term Commitment: Need to stay long enough for value to grow.
- Larger Responsibility: Yard work, home maintenance and emergencies.
- High Fees to Obtain and Sell the House: Closing costs, realtor’s fees, etc.

Find a HUD-Approved Pre-Purchase Counseling Agency Near You:
They offer homebuyer classes and can refer you to available down payment assistance programs.

Non-Interest-Bearing Financing: The Minnesota Homeownership Center has released a Guide to Non-Interest-Bearing Financing in Minnesota. This practice is a critical part of accessing homeownership formany faiths and is a hot emerging topic relevant to efforts aimed at reducing the homeownership gap. The guide was developed with input from Local Initiatives Support Corporation (LISC) Twin Cities, the Federal Reserve Bank of Minneapolis, NeighborWorks Home Partners, African Development Center and Minnesota Housing.

Be Cautious with These Homeownership Options: Mobile Homes, Rent to Own or Contract for Deed.
These types of homeownership options can be risky and might not turn out to your benefit.
If you are considering one of these options, seek advice from a HUD-approved counselor.

LSS Financial Counseling

888.577.2227

LSSFinancialCounseling.org

LSS Financial Counseling is a service of
Lutheran Social Service of Minnesota.