



Extension

UNIVERSITY OF WISCONSIN-MADISON

Ways to get out of debt

When bills like hospital and other medical bills, credit cards, and other debts come with amounts owed that are bigger than last month, it can seem like you'll never be able to get them all paid off. There are several different ways of tackling debt. Take a look at the choices below and pick the one that works best for you.

Snowball/Avalanche Methods

These DIY strategies don't cost any extra fees but you do need to have some extra money in your spending plan, also known as a budget, that you can spend on paying off your debts. You also need to be sure not to increase your debt while you're paying it off. In the **Snowball** method you pay off your smallest debts first to help get your plan moving. In the **Avalanche** method you focus on your debts with the highest interest rates so that you can cut down the total amount you'll have to pay. The PowerPay worksheet has a lot more information on these methods.

Advantages of Snowball/Avalanche Methods	Disadvantages of Snowball/Avalanche Methods
Helps you build good financial habits	You need to have extra money each month that you can use to make snowball or avalanche payments
You'll pay off your debts much faster than if you make minimum payments	You need to keep track of your balances and payments and try not to take on new debt
You don't have to sign up for an official program	Your interest rates aren't reduced like they might be if you get a debt management plan
Paying down your debts can improve your credit score	

Debt Management Plan (DMP)

In a debt management plan, you work with an organization that has been certified by the National Foundation for Credit Counseling (NFCC) and they consolidate all of your debts into one monthly payment with much lower interest rates. They are able to negotiate with your creditors to reduce your interest to as low as between 6%-10% (consolidatedcredit.org).

Advantages	Disadvantages
You only have one debt bill to pay each month because your debts have been consolidated into one payment	DMPs can only be used for things like credit cards, personal loans, and collections, so not car loans or student loans
Interest rates are reduced by an average of 75%	To use a DMP you have to close your credit cards
Your credit score can go up over time thanks to making regular on time payments	You might have a drop in your credit score at first because of closing accounts
Can help avoid bankruptcy	

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Balance transfer

Some credit cards offer a low or 0% interest rate for a limited time after you first get the card. This can allow you to move balances that you owe on other cards to the new card and pay them off at lower interest. After the introductory period the interest rate usually goes up dramatically so it's important to pay the full debt before that happens.

Advantages	Disadvantages
Could eliminate the interest that you have to pay (during the introductory period)	The interest rates after the intro period might be higher than what you were paying on the original cards
Can consolidate multiple payments onto one card	Can only transfer credit card debt, not other debts
Can pay off your debts more quickly if you increase your payments during the interest-free/low-interest period	Might be tempted to run up new debt on cards that you've paid off
Don't have to pay enrollment fees	Have to pay balance transfer fees of 2-5% of the balance

Chapter 7 Bankruptcy

Bankruptcy wipes away all of your debts (with the exception of student loans, back taxes, and past due child support) but has major consequences (and costs) and should only be used as a last resort. This strategy only makes sense when someone is in severe financial stress and all other options have been tried.

Advantages	Disadvantages
Gets rid of most debt (car loans, credit cards, collections, personal loans) in 3-6 months	If you have student loans or child support or tax payments you still owe those
Stops collectors from trying to get you to pay	Makes it hard to get new credit
Gives you a fresh start	Stays on your credit report for ten years
	You have to pay court fees to file bankruptcy

Which debt reduction method do you think would work best for you?

What are the first steps you need to take to get started with paying off your debt?

What support will you need and who can help?