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Prioritizing Expenses and Debt

When money is tight, many families and individuals have to make tough decisions regarding repayment of debt. When facing such decisions, how do you know which to pay first and which to delay? After all, everyone you owe wants and expects to be paid. This fact sheet provides strategies to help guide you through the process of prioritizing and making those decisions.

When prioritizing debt, it is important to understand that debt is divided into two types: unsecured and secured. Secured debt has some type of collateral, or property, that a creditor can take if you do not repay the debt. Common types of secured debt include mortgages and car loans, and other loans that are secured by some type of household debt, such as a refrigerator or sofa. Because of this collateral, secured debt is often your highest priority. Unsecured debt is not attached to property that can be taken if the debt is not paid, though there are some actions that can be taken against the borrower. Common types of unsecured debt include credit cards, medical bills, and store or merchant cards. Because nothing is securing the debt, these debts are generally a lower priority. When deciding what debts to pay first, you generally always start with the highest priority debts then move to the lower priority ones.

To begin the process, you must first have a good understanding of your current situation. This will require making a list of all current expenses and income. Expenses should be reviewed carefully to determine if there are any areas that can be reduced or even cut out completely. Once this is done, you can begin to prioritize your expenses and debts.

The most important priority should always be meeting family needs. Food, water, and immediate medical needs (not outstanding medical debt), should always take first priority. While there may be ways to reduce the costs, these items should not be overlooked.

The next priority should be debt related to housing. Mortgage payments, rent, insurance, taxes, homeowners' or condo fees, lot payments should be paid next, as failure to pay them could lead to the loss of your home. If you are not able to make your home payment obligation, consider foregoing lower priority expenses and put money allocated for those payments toward this payment. While there may be some consequences to not paying those debts, they are not as severe as losing your home. In addition to payments for the home, pay the lowest amount needed to keep essential utility services going. It is of no benefit to have a home if there are no lights, water, or other utility services.

In addition to essential family and housing expenses, vehicle payments are of high priority. This is especially true if you need to keep the vehicles for work or other transportation needs. Be sure to keep up with any insurance that is legally required. If you have an auto loan and do not have the required insurance, you can be forced to use insurance of the creditor's choosing, which is normally much more costly and offers less protection.

Other high priority expenses are those with legal obligations, such as child support payments, income tax debt, and student loans. The consequences for not paying these debts can be severe. Student loans are a medium priority debt requiring special consideration. Failure to repay government-backed student loans can lead to garnishment of wages and federal benefits, seizure of tax refunds, and denial of new student loans and grants. There are many options for easing the burden of student loans, including affordable payment plans, loan consolidation, and, in very rare cases, loan cancellation. Always inquire as to whether any of these options are available for you.

After the high priority debts have been taken care of, you'll want take a look at the lower priority debts, such as credit cards, medical bills, private student loans, and other debts not secured with collateral. If there is enough income left after high priority debts are paid, prioritize your low priority debts, and pay what you can. Contact these lenders and see if they are willing to work-out alternative payment options.

If you find that your finances are not adequate to cover your high priority debts, tough choices may have to be made. If you are not able to make full payments on secured debts, talk with the lender and inquire if they would be willing to take partial payments. If they are not willing, save the money you would have paid to them to use later. In the case of a mortgage, this money can be used to get caught up, or, if there is no alternative but to sell the home, to move to a new residence. If the debt is truly unaffordable, be it a home or vehicle, it may be best to sell the property or to voluntarily give it back to the lender in exchange for forgiveness of any deficiency. A deficiency is an amount left over after the property is sold that is the difference between what is owed and what was received when the property was sold.

If all else fails, you can consider filing bankruptcy. Bankruptcy is a federal process that allows borrowers protection from creditors. Bankruptcy offers the opportunity to permanently wipe out most debt (Chapter 7) or to catch up on debts through a structured repayment program (Chapter 13). Because bankruptcies can be complicated, it is often best to consider getting professional help from an attorney who specializes in consumer law and bankruptcies. Bankruptcy attorneys can help you determine which path is best for you and your circumstances.

Financial troubles can happen at any time. The best way to deal with them is to look at your income and then prioritize your expenses. Tracking your expenses can help in finding money to use to repay debt. Careful examination of your expenses can often uncover "leaks in spending" as well as expenses that can be cut back or even eliminated. For help with budgeting, check out the publications Managing Your Money and Planned Spending.

For more information on dealing with debt, check out the National Consumer Law Center's *Guide to Surviving Debt,* or Nolo's book *Solve Your Money Troubles: Debt, Credit & Bankruptcy*.

References:

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