Personal
Finance

Your Debt Priorities

Which financial commitments should you focus on first?

Sometimes that question is the most critical of all. Here's how to figure out how to attack your monthly obligations in order to maximize saving power:

GETTING STARTED

Obviously lowering all balances is the quickest pathway. But often times one debt is more pressing than another, because of high interest fees. At the same time, however, there are other responsibilities. So start by making a list of every monthly bill, with a column for essentials (house and car notes, utilities, etc.) and a second one for other debt. Focus on the second column, since there may be additional fees associated with these bills which demand your attention.

EVALUATING DEBT

The National Consumer Law Center's top suggestion is to "prioritize debts whose non-payment immediately harms your family." So paying down high-interest bills always comes second to the things listed in your column of essentials.

High, medium and low priorities follow, based on a variety of factors – including whether you're behind on the bill and, most often, how much interest the account is accruing. Look for the NCLC's online digital book called "Surviving Debt," which offers advice and tips for anyone who is struggling to pay their bills.

HIGHEST FIRST

One common approach employed by those in debt is to focus on bills with the highest interest rates, since the additional fees can make pay offs so difficult.

Make a budget, and stick to it. Just understand that these high-interest bills will usually be the most expensive, so changes might be needed in order to keep from disrupting payment in the critical first column of monthly bills. Avoid unnecessary every-day expenses like eating out, and wait on planning out-of-town vacations or purchasing any unnecessary big-ticket items.

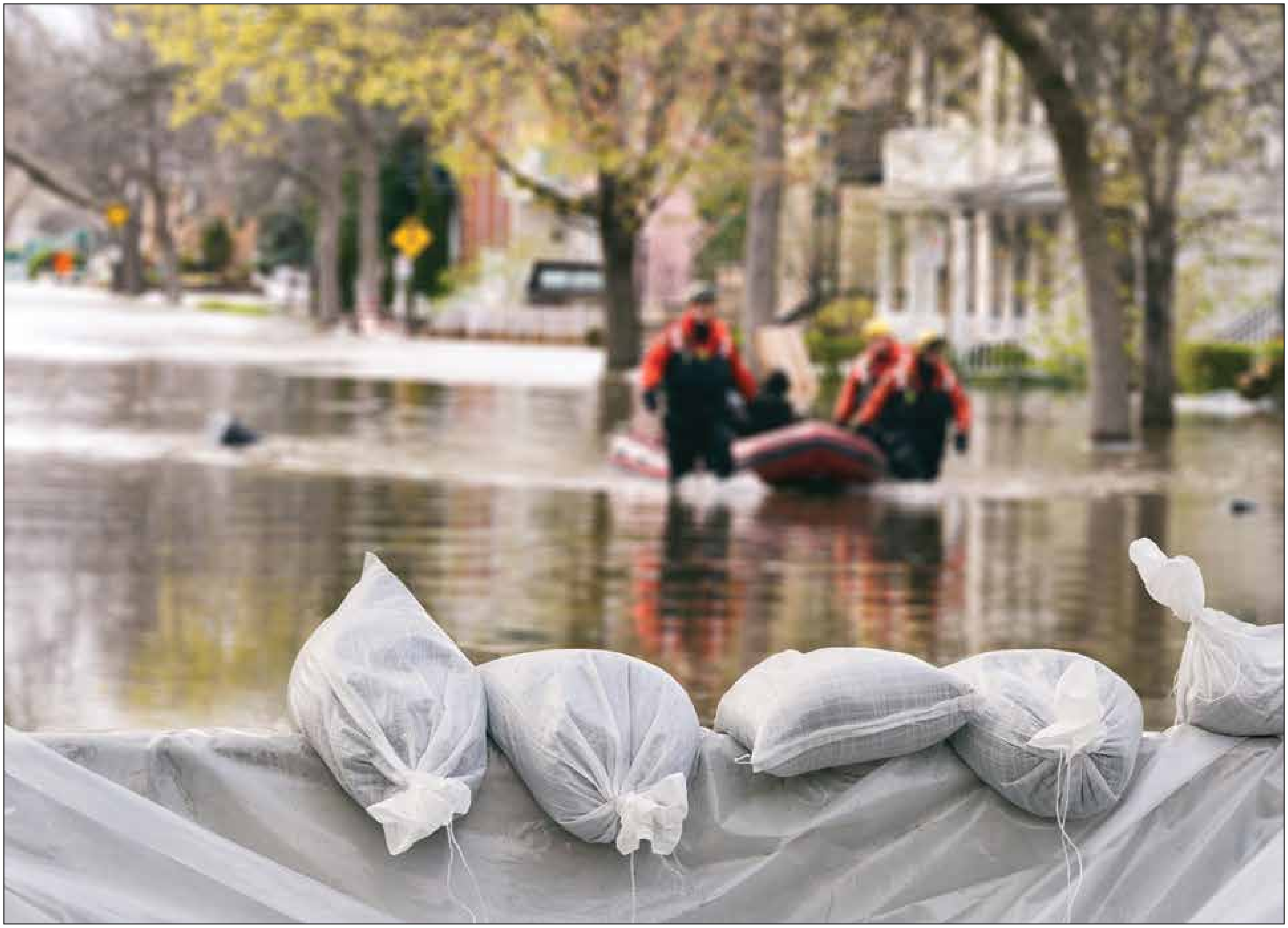
Even your wardrobe should remain as it is until you've completed these billing cycles.

BIGGEST FIRST

Others may decide to pay off the biggest bills first, irrespective of their interest rates. You'll be eliminating the most expensive monthly obligations, bolstering both your credit rating and your ability to divert cash into savings.

Once the first bill is paid off, continue down the line. Just remember that it's important to keep some level of active credit in order to maintain a desirable score.

Planning For An Emergency



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Making the right financial choices beforehand can help lower your stress, limit disruption and smooth the way forward.

Whether you've experienced one of this era's more powerful storms, an unexpected family crisis or sudden issue with employment or health, follow these simple planning strategies to limit the impact:

EMERGENCY FUNDS

The weather can turn, leading to high winds, flood or fire. Economies are no different, as we've seen with the 2008 banking crisis and the 2020 pandemic. Sudden changes with these outside forces can have a huge personal impact, in particular if you don't have a reserve of needed funds to rely upon. Protect yourself from these unplanned hardships by saving money to help bridge financial gaps when emergencies happen. How much will depend on you or your family's particular needs, but bank officials and financial planners typically recommend that you keep enough cash saved to take care of between three and six months worth of bills.

CLOSE EVALUATION

There are several financial markers that illustrate how prepared you are to navigate through any sudden issues. Monitor levels of general savings, as well as income, investments and debts. If there is obvious room to improve, begin by creating a budget that balances what you make against what you owe. Make smart cuts early, before disaster strikes, in order to create an emergency fund. Those choices are far easier to make when you're not dealing with a pressing crisis.

ORGANIZE DOCUMENTS

When disaster strikes, you'll have to gather a series of critical documents in order to make insurance claims. You'll also need access to government documents like passports, and your living will. If this paperwork is tucked away in different places all over your home, it may be difficult to find under trying conditions.

Place it all in a fire- and water-safe lockbox or in a safety-deposit box, along with cherished heirlooms and other collectibles.

INSURANCE CONSIDERATIONS

Do deep dive into your insurance before you have to file a claim. This crucial umbrella of protection is an essential part of emergency planning, but may also come with certain conditions or limitations. Know what your policy covers and does not cover before it's needed. Righting the financial ship after an emergency may be far more difficult if you don't have the right kind of insurance, or the right amount. For instance, disability coverage may be required.

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What's Your Score?

The good news is, you can improve your score – even if it's not quite where you'd like right now.

Here's more information on score ranges, the different kinds of scores and how credit bureaus arrive at these grades.

WHAT ARE THE RANGES?

Ranges depend on the model, but in general excellent credit scores are 800 or higher. Very good credit is 740-799, followed by good at 670-739, with fair and poor levels following. In truth, there isn't a magic number which will guarantee a car loan, new credit card or favorable mortgage rate. Higher scores suggest that you are responsible with your bills and credit, but different lenders may use different scales to determine your eligibility.

WHY SO MANY SCORES?

You may find that your credit score varies depending on which consumer reporting agency you're checking in with.

The three largest CRAs include Experian, TransUnion and Equifax. Some lenders may not report to all three. Different lenders may also use different formulas to zero in on your pay history. For instance, auto dealers might focus in on previous car loans.

HOW THEY'RE CALCULATED

The reported information on your credit report determines your score. They may vary, but generally these reports focus on payment history – the most significant element in calculating your score. This information includes any open credit accounts, with an emphasis on late or missed payments, debt collection and bankruptcy filings. They'll also take into account the total amount of available credit vs. the amount used. Known as debt-to-credit ratio or a credit-utilization rate, these numbers are expressed by percentages. Generally, lenders favor a number of 30 percent of lower.

OTHER CONSIDERATIONS

Some reports also take into account the type of accounts, with installment debts like mortgages and car loans separated from revolving accounts like credit cards.

The length of your credit history is usually evaluated, as are the number of recent inquiries about new credit. Too many inquiries may indicate that someone is taking on more debt than they can afford.

All of these things may have a direct impact on your ability to earn more favorable terms when taking on new debt. A better score translates into lower interest rates and lower payments, and over the life of these accounts could end up literally saving you thousands and thousands of dollars.

Understanding Mortgages

It's best to understand the details both large and small which go into these complex agreements. Otherwise, you'll be subject to huge financial risks.

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TYPES OF LOANS

There are a number of different loans, but they generally can be broken down into conventional, FHA, VA, USDA and bridge loans. As the name implies, conventional loans are the most common mortgage products. Specifically, they are not guaranteed or insured by the government, according to the Consumer Financial Protection Bureau.

These loans are typically less expensive, but are harder to secure. You'll need a down payment of at least 20 percent of the property's list price, according to Realtor.com.

Federal Housing Administration, Veterans Administration and USDA loans are all government-sponsored and backed. FHA loans are low down-payment products which are available for those with lower incomes or bad credit. In some cases, according to Realtor.com, the down-payment requires is as low as 3.5 percent – but there are loan limits. FHA loans require mortgage insurance, or PMI, which usually amounts of some one percent of the total loan amount.

VA loans are specifically designed for those who have served in the armed forces, and require no mortgage insurance or down payment. The only limitations is that these loans are only for primary residences. USDA loans are for buyers in rural areas, with discounted interest rates and no down payment. This loan requires mortgage insurance if your debt-to-income ratio exceeds 41 percent. Finally, bridge loans are designed for those who haven't yet sold their previous home. Both mortgage payments are combined until the first property is sold, paid off or refinanced.

INTEREST RATES

The most popular, and safest, choice for home buyers is a fixed-rate loan – and almost all loans fit into this category. A single interest rate applies, making it a lower risk option.

This is particularly useful for those who plan to remain over the entirety of the loan. Adjustable-rate mortgages typically start out with lower monthly costs than fixed-rate options, but after five to 10 years may be adjusted annually to match current rates. Experts typically only recommend this kind of loan for those who plan to sell before the initial rate expires. They're usually easier to secure for those with lower credit scores.

After You Get A Raise

There are savings to be had, tax considerations and potential investment opportunities that are far more important.

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Here are some key things to be aware of when you finally get that hard-earned bump in salary:

TAX BRACKETS

Depending on how much you were making or the size of the raise you were given, it's possible you moved into a different tax bracket. That could mean a larger bill at year's end. Discuss these changes with a financial advisor or accountant, so they can make sure you're federal contribution lines up with this new salary figure. They'll look at gross pay and where you'll end up, enduring that you avoid any future tax shocks. If they recommend a change in withholding, contact your company human resource or payroll department. Next, consider how you could leverage these new funds to build a better future for yourself.

RETIREMENT INVESTING

One of the very best uses of these new funds is in your retirement. Add more to your retirement contributions to create a more stable future for yourself. In particular if the company matches your contributions, your raise could substantially grow when deposited into the 401(k) or individual retirement account. Make sure to meet the maximum amount they allow in order to double your contributions. Either way, many employers sponsor a process where these contributions can be made by drafting from your regular paycheck. It couldn't be more hassle free.

PAYING DOWN DEBTS

Considering using this extra money to pay down some outstanding debts, since that will increase your buying or saving power while improving your credit score. Mortgages, car loans, utilities and credit-card bills can end up absorbing much of your regular pay. Lowering discretionary credit-card obligations is often the easiest pathway to financial freedom.

CREATING AN EMERGENCY FUND

There are short-term joys associated with faraway trips and shiny new things, but having peace of mind when the unthinkable happens will have more lasting positive impacts. America's Debt Help Organization recommends having enough savings to cover at least three months in regular expenses – though ideally, you should have six months on hand. Take the additional funds provided by your raise and build an emergency fund so you can push through the tough times without resorting to loans or high-interest credit options.

Saving For College

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Undergraduate tuition, room and board and associated fees rose nearly 30 percent over the last decade.

In fact, the National Center for Education Statistics tracked notable increases across the board, from public schools and nonprofit institutions t private for-profit colleges. Experts expect those numbers to continue to rise for the foreseeable future.

That's made it all the more important that you save, and begin saving early, in order to have a deep well of funds to ensure your child's education – even it it's just to augment possible scholarships or grants, if any. Here's how to get started:

A SIMPLE PLAN

The most widely used qualified tuition option is called a 529 plan. Sponsored by states, educational institutions and other agencies, the plans are divided into education-savings and pre-paid tuition options. The pre-paid option allows guardians to purchase credits at participating institutions for future fees and tuition – but, crucially, the prices are locked in at current levels. There are restrictions: These funds can only be used at colleges and universities, not secondary or elementary schools – and they typically may not be used for room and board. There are also often residency requirements.

Educational savings plans, on the other hand, allow guardians to create an investment account for future expenses. This may be applied to tuition, room and board and fees. Withdrawals can be directed to any institution nationwide, and also to some schools which are outside of the United States. They can be used for elementary and secondary learning as well, but there is an annual cap.

TAX IMPLICATIONS

There are certain tax benefits with a 529 plan, but they are dependent on the options and the state in which you live. Some states allow deductions on your taxes based on annual contributions, or even matching grants.

529 plan withdrawals are exempt from federal taxes, and in some cases are not subject to state income taxation, either.

FINANCIAL AID

529 plans may have an impact on the level of financial aid that's offered through your child's school. Balances from these plans, for instance, may be factored into a student's need-based grants. But for those who rely on the bulk of college funding from student loans, the 529 plan helps limit the amount of debt carried after graduation.

Need A Hand?

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Most people have no problem balancing their checkbooks, or keeping up with monthly bills. But what about more complex duties?

There's help available for those who may be having trouble juggling things like retirement accounts, living wills, freelance income or an investment property. Which one's right for you? Here's a breakdown:

BOOKKEEPERS

For those looking for help with the most basic of personal finance issues, you'll most likely look to hire a bookkeeper. They provide services like budgeting, checkbook balancing, spending analysis and assistance in keeping up with monthly bills and statements. Expect to pay $20 or more an hour for their services, according to Investopedia. Look for bookkeepers who have been certified by the American Institute of Professional Bookkeepers, or who have completed certified online training by a recognized organization like Quickbooks.

ACCOUNTANTS

Accountants are experts at more complicated financial issues, so their recommended for those who own a business or rental properties, earn in excess of $200,000 a year, anticipate sizable capital gains, have multiple sources of income or are involved with complex estate planning. They'll examine, prepare and keep records to smooth the way, handling bookkeeping as well as tax preparation and the filing for various require paperwork and forms. They're typically paid $35 or more, according to Investopedia.

For those in the most complex financial situations, consider hiring a Certified Public Accountant. They have master's degrees and are certified through the American Institute of CPAs, and also reportedly charge $50 or more per hour.

FINANCIAL PLANNERS

Financial planners can help develop strategic plans to pay down debt, budgeting and investing. The safest option is to hire a planner who only charges a flat fee. Others may require a percentage of your asset for their services, or a commission based on the investments they recommend – and that may lead to a relationship where your best interests aren't always front of mind.

MAKING THE CHOICE

Whichever professional you choose to hire, study up before deciding. Ask family and friends for recommendations, check with professional organizations and study online reviews. State securities agencies will also have searchable databases that will reveal any past issues. Meet with several possible candidates, and come prepared with detailed questions about qualifications, commissions, experience and additional fees.