

Rebuilding After a Financial Crisis

There are many things in life that can derail even the best money management plans, such as unexpected car or home repairs, illness, or job loss. When in crisis mode, most people just take things day by day, hoping to get by. When the dust settles, they are often left with a financial situation that is less than rosy. There are no savings to speak of. Their credit is shot. There is debt that needs to be paid. However, with hard work and dedication, a healthy financial future is possible.

This module covers the steps you can take to rebuild after a financial crisis, including:

- Budgeting
- Debt Repayment
- Rebuilding Credit
- Emergency Savings
- Replenishing Retirement Savings

Chapter 1: Budgeting

Regardless of whether you are a millionaire or making minimum wage, the foundation of financial success is the same – budgeting. Budgeting means analyzing what you have coming in, then developing a reasonable and goal-oriented plan for what goes out. Essentially, a budget is a tool that can help you make the most out of your money. With it, you will be able to pay your bills on time, save, and eliminate debt.

Use the Budget Worksheet to list your current income and expenses. If you don't know exactly to the penny what you are spending on groceries, clothing, or other items, don't fret. Just put down your best estimate for now. By tracking your expenses for a period of time (you can use the Tracking Worksheet or a computer spreadsheet), you can – and should – create a more accurate budget in the future. Don't forget to include debt payments and savings. For periodic expenses, such as vacation, determine the annual amount and divide it by twelve.

- **Complete the Budget Worksheet, pages 6-8**
- **Complete the Tracking Worksheet, pages 9-10**

Though no two budgets are alike, there is a common rule: expenses should never exceed income. If you are currently spending more than you are earning, think about ways you can increase your income and/or reduce your expenses. Can you get a part-time job? Rent out a room in your house? Cut back on dining out? Skip the daily \$4 mocha latte? Get a cheaper cable package or cut your land-line phone? Increasing income can be difficult, but most people have some expenses they can trim. Honestly assess what is a necessity and what isn't. List the changes in the proposed column of the budget worksheet.

Your budget is only helpful if you follow it. Tracking your expenses on an on-going basis can help you recognize when you should stop spending because you have reached your limit in a particular category. However, if you overspend once in a while, try not to get discouraged. No one is perfect. If it happens often, you may need to readjust your budget so that it is more realistic. For example, perhaps you can't keep your food costs at \$150 a month, but you can cut back on your clothing purchases.

Chapter 2: Debt Repayment

Financial crises and debt problems often go hand in hand. Many people rely on credit to get them through the storm, then have to face repaying a boatload of debt. Not being able to keep up with payments is also common.

You probably would rather repay your debt than ignore it, especially if you are getting hounded by bill collectors. The first step in tackling debt is establishing an accurate inventory of who and how much you owe. If you have a stack of unopened bills on your kitchen table, take a deep breath and open them. If you don't have recent statements, call your creditors and ask them for up-to-date account information. You can list your debts in the Debt Worksheet (make sure to include the monthly payments in your budget).

- Complete the Debt Worksheet, page 11

Next, create a plan of attack. You may want to vary your approach depending on the status of the account.

Accounts in good standing

If you have accounts that you were able to keep current, they don't require any urgent action. However, keep in mind that if you owe a significant amount and only pay the minimum required payments, it could be years before you are debt free.

One way to accelerate debt repayment is to pay more than the minimum. You should only do this if you are comfortably meeting your all of your debt and other obligations. (It doesn't make sense to pay an extra \$100 a month on your credit card if you are three months behind on your phone bill.) If you have multiple accounts, it is better to be systematic and focus your extra payments on one creditor at a time instead of sending a little extra to everyone. Many people like to start with the debt with the lowest balance because it can be paid off the soonest, providing a sense of accomplishment that makes it easier to keep going. However, you will save the most money by starting with the debt with the highest interest rate. Once the first debt is paid off, put that money toward the debt with next lowest balance or highest interest rate (depending on the option you choose) and so and so on until all of the debts are paid off.

Debt repayment can also be accelerated by finding ways to lower your interest rates. Want to know a simple way to get a lower rate? Just call your creditors and ask. They may say no, but it only takes up a few minutes of your time. If you have a good credit score, you could also look into transferring balances to a low-rate credit card or getting a consolidation or home equity loan. However, you have to be very careful to not charge up the old accounts – you could wind up with more debt than you had before. Another option is a debt management plan (offered through credit counseling agencies), in which many creditors give you lower rates in exchange for closing your accounts and going through counseling. It is very important to use a reputable agency – ask your financial institution for a referral if you are interested.

Delinquent accounts (not with a collection agency)

It is a good idea to tackle any account you are delinquent on right away. If you fall far enough behind, it is possible it will be charged off and sent to a collection agency, which will severely damage your credit report. (This typically happens after 4-6 months of non-payment).

When you fall behind, usually the payments you miss are added to your minimum required payment. You may be wondering how you can catch up if your creditor is expecting \$1,000. Keep in mind that the payment listed on your statement is not necessarily the only option. Most creditors want you to pay your bills and are willing to work with you. Give them a call and ask if it is possible to pay the back amount over a few months. You can also see if they are willing to settle the debt for less than the amount owed. Typically, when you settle, you must pay the amount all at once or within a short period of time, so it is more practical for smaller debts than larger ones.

When you are talking to a creditor, remember to remain calm and polite. It is easy to get frustrated, but would you be more likely to help someone who was nice to you or who screamed? If you don't succeed at first, don't give up. Ask to speak to a supervisor. Call back at another time. Send a letter. (Make sure to send it to the address for billing inquiries and concerns, not the payment address.) Ultimately, the creditor may not agree to anything, but at least you will know that you tried your best.

Collection accounts

Once an account goes to a collection agency, the damage to your credit report has already been done. Paying off collection accounts shouldn't be your number one priority, but it is not a good idea to permanently neglect them either. You probably don't want to be worried about bill collectors breathing down your neck, and you could be sued for not paying a debt.

Collection agencies are usually very willing to settle debts for a fraction of the amount owed. You should always get a settlement agreement in writing before sending a payment. Although they are not required to do so, as part of the settlement agreement, you can ask them to remove the collection account from your credit report. At the very least, they are required to report that the account was paid. Check your credit report a month or two after settling to make sure they did. (If not, you can submit proof of payment to the credit bureau.)

Most collection agencies will also accept monthly payments. Even if they say they won't over the phone, chances are, they'll cash your check instead of throwing it in the trash. Since you may not receive statements from a collection agency, it is very important to keep your canceled checks or other proof of the payments you made. Keep in mind that while sending monthly payments may be enough to satisfy them, it is possible to be sued as long as you have an outstanding balance and the statute of limitations has not expired. (The statute of limitations is the amount of time that a creditor has to pursue legal action against you to collect a debt. It varies from state to state.)

Beware of debt settlement agencies

Have you ever seen commercials on television for companies that promise to help you settle your debt? Don't call the number on your screen. They typically charge high up-front fees and may not contact creditors for several months, if at all. In the meantime, your accounts fall further behind, late charges get piled on, and you could get sued. You are much better off negotiating with your creditors on your own or going with a reputable credit counseling agency.

Chapter 3: Rebuilding Credit

All of your credit activity is tracked by your credit report. It includes the payment history and balances owed on credit and store cards, personal loans, student loans, car loans, and mortgages as well as credit-related legal activity, such as foreclosures, repossessions, evictions, judgments, and bankruptcies. Your credit score is a numeric rating of the information in your credit report and is designed to measure the risk you won't repay what you borrow. When you apply for new credit, the creditor typically checks your credit report and/or score to determine whether or not to approve you and what interest rate to give you. Landlords and insurance companies also frequently check them when deciding who to rent to and what rate to charge, respectively. Even some employers check them when making hiring decisions.

As you can see, having a good credit report and score can make life a little easier. However, when people are experiencing a financial crisis, they often do things that negatively impact them, such as skip payments or charge up high balances on credit cards. You can't undo the past (most negative information can stay on your credit report for seven years), but there are many steps you can take to have a better credit report and score in the future:

- **Pay on time, every time** – A commitment to never make a payment late again is one of the most powerful steps you can take to improve your credit rating.

- **Pay down existing debt** – Even if you have never missed a payment, a large debt load will lower your score. Explore ways you can lower your interest rates and free up cash to make more than the minimum payments.
- **Avoid taking on additional debt** – Besides paying down existing debt, make an effort to not take on more debt in the future. Ideally, you should not charge more than you can pay off in full the next month, but at the very least, keep the balances on revolving debt, such as credit cards, under 50% of the credit limit.
- **Dispute errors** – Many credit reports contain mistakes. Perhaps someone else’s collection account appears on your report, or you were marked late on a credit card you always pay on time. That is why it is a good idea to periodically review your credit report from each of three credit bureaus: Equifax, Experian, and TransUnion. You can get a free copy of your credit report annually from the Annual Credit Report Request Service, www.annualcreditreport.com, 877-322-8228). If you see any errors, contact the relevant credit bureau and dispute them.

What if all of your accounts were closed? Besides paying off outstanding debt, there is not much you can do to improve your score without having active accounts in good standing. Getting new credit can be tricky if your credit score is low, but there are a few options. One possibility is a secured credit card. This type of card requires you to put down a deposit, which the creditor gets to keep if you do not make payments. While it is typically easier to get than a regular credit card, the credit limit is usually low, and the fees can be high. However, many creditors are willing to convert a secured credit card to a regular credit card after a year or two of on-time payments.

Another option is to ask a friend or family member who has a good credit history to cosign for you. Be especially careful with this type of arrangement. Any late payments you make will not only reflect poorly on your credit report but your cosigner’s as well. After six months to a year, you may want to reapply for credit on your own.

Beware of credit repair

Some companies claim to “repair” credit reports, often for a very high fee. At best, the company is charging you for something you can do yourself for free – writing a letter to the credit bureaus disputing inaccurate information. At worst, the company is engaging in dishonest and/or illegal tactics.

Credit repair companies frequently operate by flooding the credit bureaus with letters that dispute negative, but accurate, information. If they are unable to investigate the claims within 30 days, the information is removed. The company then shows you a cleaned-up report. This rarely works long-term, though. Even if the credit bureaus are backlogged with disputes, they will get to your claims and just reinsert the negative information when they verify that it is accurate.

Another common tactic credit repair agencies use is to issue consumers a “new identity,” complete with a stolen or new Social Security number or tax identification number to use in place of a Social Security number. This is an illegal practice for which the consumer often ends up paying the price. Remember, there is no legal way to remove accurate and timely information from your credit report.

Chapter 4: Emergency Savings

You probably don’t want to think about the troubles that could occur in the future, but unfortunately, bad things can happen to good people – more than once. Should you be hiding under the covers, shaking in fear? No. But it is a good idea to do what you can to prepare.

One of the best things you can do to prepare for the unexpected is to save. With savings, you don’t have to put unexpected car repairs or medical bills on your credit card or worry about how you will pay your mortgage and

electric bill if you lose your job. Financial experts recommend establishing emergency savings of at least three to six months worth of essential living expenses. If you do not already have that amount, determine how much you can set aside each month until you reach your goal. Since you don't know when you will need the money, make sure that it is put in an account that is easily accessible and where there are no penalties for early withdrawal. A savings account is usually a good choice.

Saving is easier if you make it an automatic process. If you have direct deposit through work, you should be able to have a portion of your paycheck deposited into your savings account. Additionally, many financial institutions allow you to set up a periodic automatic transfer of funds from your checking account to your savings account.

Chapter 5: Replenishing Retirement Savings

When people are experiencing a financial crisis, they often turn to their retirement fund for assistance, taking out a loan or withdrawing money. Reducing or stopping contributions is not uncommon either. Even people who have no problems paying their bills frequently are contributing little or nothing.

If retirement is several years or decades away, it is easy to push it to the side and focus on more immediate concerns, but saving for retirement is not something that can be done last minute. Okay, you can do it last minute, but you won't be able to save much. Think about all of things you want to do in retirement: travel, play golf every day, at the very least, eat and have a roof over your head. You can't rely on Social Security to cover all or even most of your costs.

Borrowing or withdrawing against a retirement fund can cost you a significant amount of money in lost potential investment earnings. You can't unborrow or unwithdraw the money, but you can focus on replenishing your retirement fund. If you stopped your contributions, restart them, even if you are paying back a loan. If you reduced them, bring them back up. If you were not contributing to begin with, now is the perfect time to start. Most employers offer a retirement plan, the most common one being the 401(k), and/or you can contribute to an IRA (individual retirement account) or Roth IRA on your own. You may want to consult with a financial advisor if you are not sure how much you should be saving or what investment options you should choose.

The example below shows the benefit of continuing contributions to a retirement fund while paying back a loan you took out against it.

Salary	\$40,000 a year
Contribution amount	6% (\$2,400 yearly)
Employer match	3% (\$1,200 yearly)
Average annual return	8%
Fund balance at time of loan	\$20,000
Loan amount	\$10,000
Loan interest rate	5%
Loan term	5 years
Years until retirement	30

If you stop contributions while you are paying back the loan, you will have \$458,673 at retirement. However, if you continued your regular contributions, you will have \$578,275. That's \$119,602 more than if you stopped contributions (and only \$5,448 less than if you never took out the loan)!

Remember, an unfavorable financial situation is not set in stone. You can seize control of your finances and pay all of your bills on time, pay off your debt, have a good credit report and score, and save.

Budget Worksheet

Monthly Income. Enter your gross and net (after taxes) income from all sources. For income received infrequently, such as bonuses or tax returns, calculate the annual income, then divide by 12 to find the monthly amount.

Source	You	Spouse
Job		
Part-time job		
Rental/room & board received		
Commissions/bonuses		
Tax refunds		
Investment income		
Government benefits		
Unemployment insurance		
Child support/alimony		
Support from family/friends		
Other		
Total Monthly Income		

Monthly Expenses. Since many expenses are variable, such as utilities and groceries, it is important to average these expenses. Other expenses are periodic (such as insurance or vehicle registration). Again, calculate the annual amount and divide by 12.

Category	Expense	Average Per Month	Goal Per Month
HOUSING	Rent/Mortgage		
	2nd Mortgage/Equity Line		
	Homeowner's/Renter's Insurance		
	Condo Fees/HOA Dues		
	Home Maintenance		
	Gas/Electric		
	Water/Sewer/Garbage		
	Telephone		
FOOD	Groceries/Household Items		
	At Work/School		
INSURANCE (Exclude payroll deducted amounts)	Health/Dental/Vision		
	Life/Disability		
MEDICAL CARE (Exclude payroll deducted amounts)	Doctor/Chiropractor		
	Optometrist/Lenses		
	Dentist/Orthodontist		
	Prescriptions		
TRANSPORTATION (Exclude payroll deducted amounts)	Car Payment #1		
	Car Payment #2		
	Auto Insurance		
	Registration		
	Gasoline/Oil		
	Maintenance/Repairs		
	Public Transportation/Tolls/Parking		
CHILD CARE (Exclude payroll deducted amounts)	Daycare		
	Child Support/Alimony		
SAVINGS	Emergency		
	Goals		
INCOME TAXES	Prior Year		
	Estimated Tax Payments (Self-Employed)		
UNSECURED DEBT	Loan payment		
	Credit Card #1		
	Credit Card #2		
	Credit Card #3		
	Credit Card #4		

Category	Expense	Average Per Month	Goal Per Month
PERSONAL	Beauty/Barber		
	Clothing/Jewelry		
	Cosmetics/Manicure		
ENTERTAINMENT	Cable/Satellite		
	Movies/Concerts/Theater		
	Books/Magazines		
	CD/Tapes/Videos/DVD		
	Dining Out		
	Sports/Hobbies		
	Vacation/Travel		
MISCELLANEOUS	Banking Fees		
	Laundry		
	Union Dues		
	Internet Service		
	Pet Care		
	Gifts for Holidays/Birthdays		
	Cell Phone/Pager		
	Postage		
	Cigarettes/Alcohol		
	Contributions to Church/Charity		
	Other		
	Other		
	Other		
	Other		
	Other		
Other			
Other			
Other			
Total Monthly Expenses (include totals from page 7)			

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Bottom Line. Once you have determined the total of your take-home pay and expenses you are ready to determine your bottom line. Subtract the total of all expenses including debt payments from your net income. If the result is a positive number, you can add the extra money to your savings to reach your goals sooner. If your expenses exceed your income, you'll need to make some adjustments to bring your finances back into balance.

Total Monthly Income	Total Monthly Expenses	Balance
	-	=

Weekly Expense Tracking

If you don't know where your money is going, it's time to start tracking your spending. Different methods of tracking work for different people – some like to save receipts while others prefer to jot down all purchases in a small notebook they carry with them. Remember, tracking is only effective if you count every expense, including the morning newspaper and the change you put in the office vending machine. Use the sheets on the next two pages to record weekly and monthly spending totals. (Make copies of the charts so that you can track for longer than one week.)

Item	Mon	Tue	Wed	Thu	Fri	Sat	Sun	Total Expenses	Weekly Budget	Over / Under
Groceries										
Restaurants										
Laundry/Dry Cleaning										
Medical/Dental										
Auto/Gas/Parking										
Other Transportation										
Child Care										
Personal Care										
Clothing										
Bank Fees/Postage										
Entertainment										
Books/Music/Video										
Cigarettes/Alcohol										
Gifts/Cards										
Home/Garden										
Church/Charity										
Savings										
Other										
Other										
Other										
Weekly Totals										

Debt Worksheet



Creditor	Account Number	Interest Rate	Monthly Payment	Balance	Months Late
1		%	\$	\$	
2		%	\$	\$	
3		%	\$	\$	
4		%	\$	\$	
5		%	\$	\$	
6		%	\$	\$	
7		%	\$	\$	
8		%	\$	\$	
9		%	\$	\$	
10		%	\$	\$	
11		%	\$	\$	
12		%	\$	\$	
13		%	\$	\$	
14		%	\$	\$	
15		%	\$	\$	
16		%	\$	\$	
17		%	\$	\$	
18		%	\$	\$	
19		%	\$	\$	
20		%	\$	\$	
Total			\$	\$	