MANAGING DEBT

COMMAND ★ YOUR CASH™

THE USAA EDUCATIONAL FOUNDATION®

OUR PURPOSE

The purpose of The USAA Educational Foundation is to lead and inspire actions that improve financial readiness for the military and local community.

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UNDERSTANDING DEBT

Credit cards. Mortgages. Student loans. Sometimes it makes sense to buy something now and pay for it later. But not all debt is equal, and some types are better than others. It might be difficult to classify any type of debt as “good,” but there are definitely “better” and “worse” debts.

Understanding the difference between the two can help you stay out of financial trouble.

Debt is like dynamite: Used carefully, it can be a great tool to help build things. Used carelessly, it can do a lot of unintended damage.

BETTER DEBT

The old saying, “it takes money to make money,” can be true. Incurring debt that potentially creates value and contributes to your overall financial health is better than other types of debt.

For example, earning a college degree usually means you will make more money in your lifetime. Because of this, a student loan to invest in yourself and future earning potential could be considered a better debt. The same could be said when you use debt to purchase things that increase in value. A house can sometimes — but not always — be a good example of this.

WORSE DEBT

Another saying goes, “if you can’t afford it, don’t buy it.” This is especially true when debt is created to purchase consumable items. The instant gratification of an expensive meal, vacation, or clothing can take months or even years to pay back without discipline. Financing a vehicle is another debt transaction that can go wrong if you’re not careful. Debts like this could be considered worse debt.

A $1500 TV financed for two years at 18%, costs $300 in interest—or as much as new gaming system.

SECURED DEBT

» A loan that requires collateral.

» The collateral is often the thing purchased.

» The bank or lender can repossess the collateral if you fail to pay them back as agreed.

EXAMPLES:

» Vehicle loan

» Mortgage loan

» Home equity loan or line of credit (borrowed against the value of your house)

UNSECURED DEBT

» A loan with no collateral, just a promise to repay.

» Often called a “signature loan.”

» Often charge higher interest rates to compensate lender for the extra risk taken given the lack of collateral.

EXAMPLES:

» Student loan

» Personal loan

» Debt consolidation loan

» Most credit cards

» Line of credit

POINTS TO PONDER BEFORE TAKING ON DEBT

Repayment term. How long will it take to pay off the debt? It can be tempting to stretch out the repayment terms of the debt just to make the payment lower but this is typically not a good idea. In most cases, the longer you take to pay, the more you pay in total. Shorter repayment terms are typically better.

Interest expense. What is the total cost of the debt going to be? When you add up all the interest you’ll pay by the time the debt is paid off, how much will your purchase end up costing you? Ask yourself if it’s worth it to pay that much extra just so you can make the purchase today or would it be better to save up and pay for it with cash instead?

Future income. What happens if your income goes down? Even if you can afford a payment today, you need to be fairly certain you’ll be able to keep making the payment until the debt is paid off. What will you do if the payment is no longer affordable at some point?

Future situation. Life changes, and what looks like a good decision today might be a burden three or four years from now. For example, service members taking on vehicle loans (including cars, trucks, motorcycles, ATVs, personal water crafts, etc.) should think about how they would handle a PCS to a location where the vehicle can’t be taken or where taking it wouldn’t make sense. What if it couldn’t be sold at that point for what’s owed on it?

HOW MUCH DEBT IS TOO MUCH?

One way to stay financially healthy is to calculate and monitor your debt-to-income ratio (DTI), or how much you owe compared to how much you make each month.

CALCULATE YOUR DEBT-TO-INCOME (DTI) RATIOS

There are actually three DTI ratios that are commonly considered: Consumer DTI, Housing DTI, and Total DTI.

If you're baking a cake, it makes sense to use the right amount of each ingredient, otherwise you could end up with a big mess.

Think of debt ratios as a recipe for your finances. Stray too far from the recipe, and you will likely need to overcompensate in other areas.

Review the examples on the next page to get a better idea of how you're doing.

CONSUMER DTI

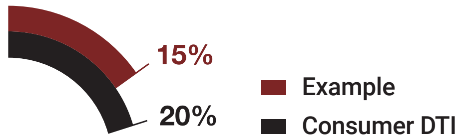
Best to keep it below 20%
(of after-tax pay)

1. Add up your total monthly debt payments — credit cards, student loans, etc. — excluding mortgage or rent.
2. Divide that by your total monthly net income (after-tax pay).

Example

Household debt payments total $400/month and total after-tax pay is $2,665/month

$$\frac{\$400}{\$2{,}665} = .1501 \text{ or } 15\%$$



HOUSING DTI

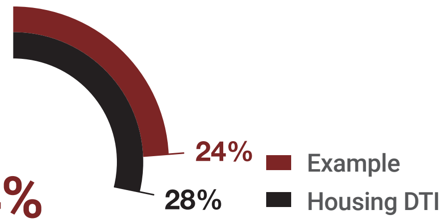
Best to keep it below 28%
(of gross pay)

1. Take your total housing payment (rent, mortgage, condo fees).
2. Divide that by your total monthly gross income (before deductions).

Example

Housing cost equals $900/month and your total gross income is $3,750/month

$$\frac{\$900}{\$3{,}750} = .24 \text{ or } 24\%$$



TOTAL DTI

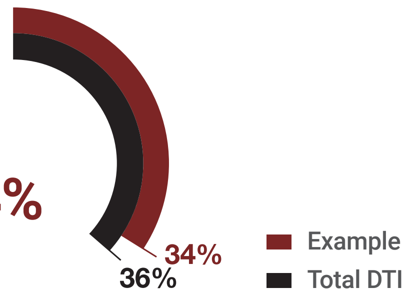
Best to keep it below 36%
(of gross pay)

1. Add your total monthly debt payments and your housing payments.
2. Divide that by your total monthly gross income (before deductions).

Example

Total debt payments equal $1,300/month and your total gross income is $3,820/month

$$\frac{\$1{,}300}{\$3{,}820} = .3403 \text{ or } 34\%$$



These examples are guidelines and should only be used to give you a general idea of your situation.

CREDIT CARDS

More retailers in a shopping center? That's a good thing. More retailer's credit cards in your wallet? Not so much. While special financing offers and discounts can sometimes be attractive, it's usually a good idea to limit the number of credit cards you have.

WITH CREDIT CARDS, LESS IS MORE

» All of your credit cards, including credit card applications, appear on your credit report.

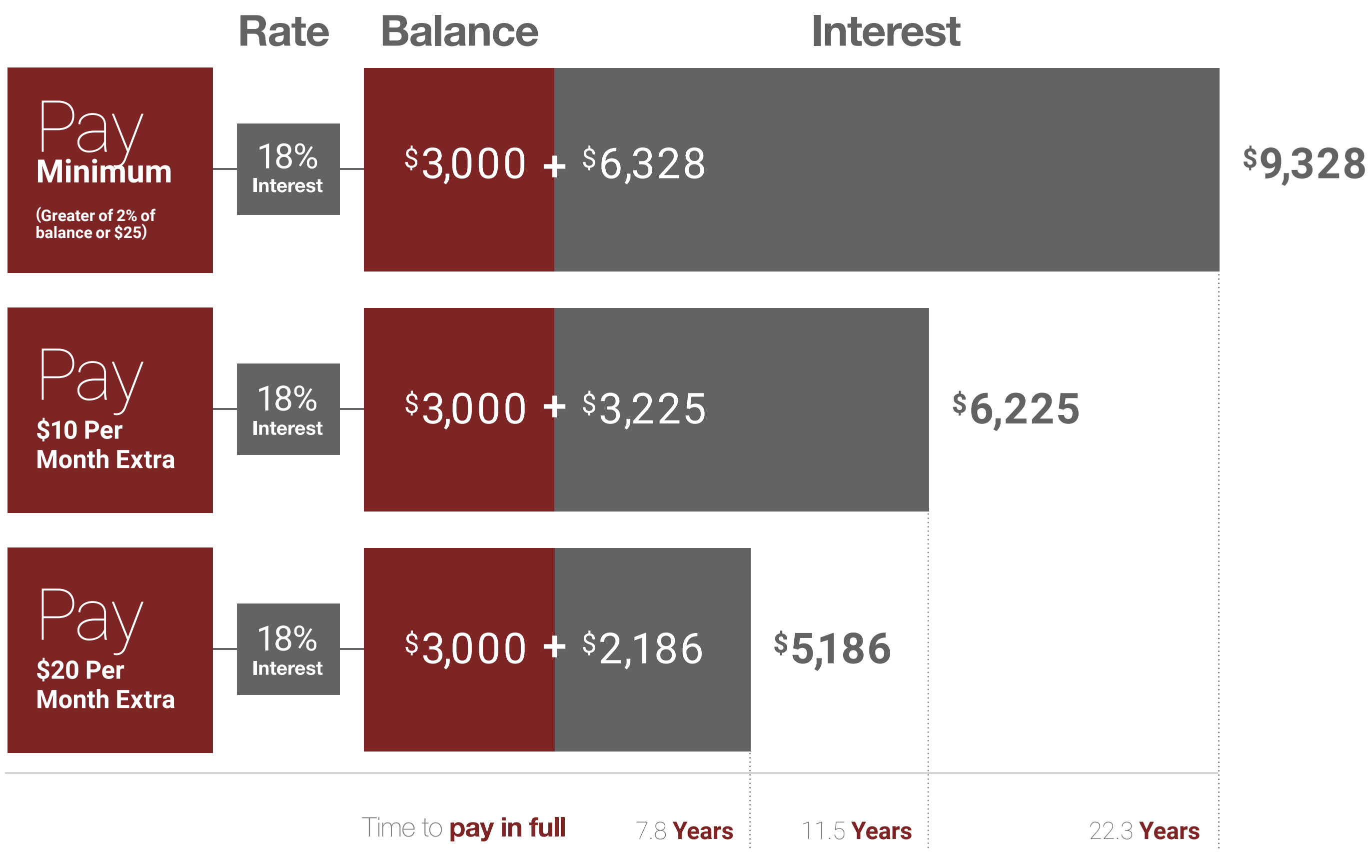
» Applying for multiple credit cards could decrease your chances of being approved for any of them.

» It's best to pay off your balance each month but if you can't, keep the balance as low as possible. This will cost you less interest and won't impact your credit score as negatively.

» Fewer credit cards make it easier to keep track of spending and reduce the temptation to accumulate debt.

HOW CREDIT CARD DEBT COSTS YOU

Always pay more than the minimum. In this example, paying only the minimum each month will take about 22 years to pay off the balance and cost more than twice the original charge. Even paying just a little more each month can make a big difference.



AUTO LOANS

VEHICLE PAYMENTS: HOW BIG IS TOO BIG?

Walk into any car dealership and sooner or later the salesperson will pop the question, “What kind of payment are you looking for?”

Before you answer that question, consider that fact that the monthly cost of owning a car or truck is much more than just your loan payment. You also have to factor in gas, insurance and maintenance costs just to name a few and those can add up to a pretty big number.

This is important because even though it may not be practical in many situations — especially for younger service members — it’s ideal if you can limit your all-in monthly vehicle costs to no more than 10% of your gross pay (your pay before any taxes or deductions are taken out). Again, keeping this category of expenses this low may not always be possible but when it comes to vehicle expenses, it’s usually better for your overall financial health to spend less, not more.

Vehicles are typically one of the most expensive purchases you’ll ever make. And while reliable transportation is important, so is having money in the bank. Be careful not to trade one for the other.

HOW MUCH CAN I AFFORD?

Even if you think you can afford to spend a large percentage of your pay on a vehicle, it's probably not a good idea… or won't be at some point in the future. A good rule of thumb is to keep total transportation costs less than 10% of gross income. When you are first starting out in life, this may be difficult to do, but try your best to keep total transportation cost low. The example below illustrates the 10% rule of thumb to guide a vehicle purchase.

AFFORDABLE PAYMENT

Angelina, a young service member, is shopping for a new vehicle. Her gross pay is $3,750 per month. Keeping with the 10% rule, let's see what monthly payment Angelina can afford.

MONTHLY TRANSPORTATION BUDGET	$375
GAS, INSURANCE, MAINTENANCE	$175
AMOUNT LEFT FOR PAYMENT	$200

AFFORDABLE LOAN

After accounting for gas, insurance, and maintenance costs, Angelina's monthly budget leaves $200 for a vehicle payment. By financing for 5 years with an interest rate of 3%, Angelina's monthly payment will allow for an $11,000 loan amount. Angelina has also saved a down payment of $2,000 and should shop for vehicles priced around $13,000.

LOAN AMOUNT	$11,000
DOWN PAYMENT	$2,000
TOTAL PRICE	$13,000

STUDENT LOANS

Earning a college degree is often viewed as a stepping stone to the American dream. A higher eduction comes with the potential to earn a greater income, but for many it also comes with student loan debt.

According to the Federal Reserve, student loan debt in America rose to over $1.5 trillion in 2018. What's worse, student loan debt is also having implications on long-term goals like retirement. A recent American Institute of CPA's survey found half of respondents say they have delayed contributions to retirement accounts due to student loan debt.

So if student loans are, or will be, a part of your future, there are some things you need to know.

TYPES OF STUDENT LOANS

Federal student loans are funded by the federal government to pay for education. They are often less expensive and offer more flexibility than private loans. Other advantages include:

» Repayment does not start until you graduate, leave school, or change your enrollment status to less than half-time.

» The interest rate is fixed and often lower than private loans.

» They can be subsidized in some cases, where the government pays the interest on the loan while you are in school on at least a half-time basis.

» They offer more flexible repayment plans than private student loans and can even be fully or partially forgiven in certain cases.

Private student loans are offered by a lender such as a bank, credit union, or school to pay for education. While private student loans provide an additional source of funds to help pay for college, it's best to maximize the use of federal student loans first.

TOP TIPS FOR STUDENT LOANS

- **Avoid Them.** The best strategy to paying back a student loan is not needing one in the first place. Explore scholarships, grants, working part-time, military programs, or employer tuition reimbursement programs to help pay for school.
- **Minimize Them.** Once you have exhausted all efforts to avoid student loans, try to minimize the amount you borrow. To save money, consider attending community college before transferring to a public or private institution. Or, consider attending a less expensive college.
- **Learn Your Options.** Visit ***studentaid.ed.gov*** for more information about paying for college.
- **Choose Federal Over Private.** If you need to borrow for college, start with federal loans first. Federal loans typically offer lower interest rates and more flexible repayment options than private loans. Federal loans also can be tax deductible, and have the potential to be subsidized or even forgiven under certain conditions.
- **Complete the FAFSA.** All students interested in financial aid should complete the Free Application for Federal Student Aid (FAFSA).
- **Understand Repayment Options.** Federal student loans offer a number of repayment options, including many that are income-based. Private loans also offer some choices for how to pay back your debt though they are more limited than federal loans. Be sure to work with your lender or loan servicer to determine the repayment options that work best for you.
- **Consolidate Carefully.** Avoid for-profit companies promising to consolidate your loans for a fee. You can often do this yourself. Visit the National Foundation for Credit Counseling ***(nfcc.org)*** for additional information.
- **Communicate With Your Lender.** If you run into trouble making student loan payments because of unemployment, health problems, or other financial challenges, it's important to communicate these problems with your lender. Though they should be used carefully, there are legitimate ways to postpone your federal loan payments, such as deferments and forbearance.

THE WORLD OF STUDENT LOAN REPAYMENT

Repaying higher interest rate student loans can feel like running on a treadmill. Every stride and every monthly payment can seem as if you are getting nowhere fast.

Fortunately, in many situations you can either refinance or consolidate your student loans to save money. In the case of federal loans, if eligible, some of your student loan debt may even be forgiven.

If you find yourself struggling to make student loan payments, it's a good idea to communicate with your loan provider immediately.

Your federal loans may be eligible for income-based repayment or even postponement. Private loan repayment options vary by lender but there are usually some choices with them too.

The bottom line is no one is going to advocate for you better than yourself. Review the chart below for possible repayment plans and visit ***studentaid.ed.gov*** to learn more about options, benefits and drawbacks.

FEDERAL STUDENT LOANS

REPAYMENT PLAN	DESCRIPTION
STANDARD	Payments are fixed up to 10 years or up to 30 years for consolidation loans.
GRADUATED	Payments start lower and increase, normally every two years. Loans are up to 10 years or up to 30 years for consolidation loans.
EXTENDED	Payments may be fixed — like the standard plan — or graduated up to 25 years.
INCOME-BASED	Payments are meant to be affordable and are calculated based on income and family size.

PRIVATE STUDENT LOANS

REPAYMENT PLAN	DESCRIPTION
IMMEDIATE REPAYMENT	Immediate start of principal and interest payments after loan is disbursed.
INTEREST-ONLY	Interest-only payments while you are in school. Principal and interest payments after you leave or drop below half time.
FIXED	Lower fixed monthly payments while you are in school. Regular principal and interest payments start after you leave or drop below half time.
FULL DEFERMENT	No payments while you are in school at least half time. Principal and interest payments start approximately six months after you leave.

PAYDAY LOANS

Payday loans often carry high interest rates, unaffordable repayment terms and coercive collection tactics. Penalties for extending loan repayment can be severe.

Obtaining payday loans is relatively easy. However, they are so burdensome that the Department of Defense (DoD) leadership has identified payday loans as a threat to military readiness.

A payday loan may appear to be a short-term solution to a temporary cash flow problem. In reality, it is a high-interest, high-fee loan that can quickly create long-term debt.

Payday loans generally range from $100-$1,000 depending on state legal maximums. They are repaid out of your next paycheck (usually within a two-week period). Problems develop when you do not repay the payday loan from your next paycheck.

THERE ARE ALTERNATIVES TO PAYDAY LOANS

» Talk to a counselor at your Military and Family Readiness support center and/or Military OneSource.

» Consult your military installation for financial counseling and information on zero-interest emergency loans.

» Research interest rates on loans offered by your financial institution, which can be more competitive.

» Consider overdraft protection for your bank account.

» Seek consumer credit counseling.

DEBT MANAGEMENT WARNING SIGNS

Warning signs of indebtedness appear long before creditors start sending collection notices. Answer the following questions to help determine if you are managing debt appropriately.

		Yes	No
1.	Are you borrowing to pay for items you once paid for with cash?	☐	☐
2.	Is an increasing percentage of your income going to pay debts?	☐	☐
3.	Are you paying bills with money reserved for something else?	☐	☐
4.	Are you taking money from savings to pay current expenses?	☐	☐
5.	Is your emergency fund (which should equal at least 3–6 months of basic living expenses) inadequate or nonexistent?	☐	☐
6.	Do you pay only minimums on your revolving charge accounts?	☐	☐
7.	Are you making payments in 60–90 days that you once made in 30?	☐	☐
8.	Are you near or at the limit on your credit cards and other sources of borrowing?	☐	☐
9.	Do you take out a new loan before an old one is paid in full or take out a new loan to pay an existing loan?	☐	☐
10.	Do you take out payday loans?	☐	☐
11.	Are you unsure about how much you owe?	☐	☐
12.	Are you chronically late in paying your expenses?	☐	☐
13.	Are you threatened with repossession of your vehicle, cancellation of your credit cards or other legal action?	☐	☐

If You Answered	You Are	You Should
"No" to all questions	Managing debt well.	Continue practicing good money management.
"Yes" to any question 1-5	Getting out of control.	Stop using credit until current debt balances are paid.
"Yes" to any question 6-11	On the verge of trouble.	Stop using credit. Develop a spending plan and debt payment plan.
"Yes" to question 12 or 13	Probably overextended.	Consult a financial planning professional now, before your financial goals become impossible to achieve.

GETTING OUT OF DEBT

Despite their best intentions, people fall into debt. But just because you're in debt doesn't mean you have to stay there. If debt payments consume more than 36% of your gross income, it might be time to get help.

TAKE CONTROL

If you become overextended, it takes personal effort and discipline to get your situation under control. These tips will help you get back on track:

- **Stop the Bleeding.** To get out of debt, you've got to stop adding to it. Go on a cash-only diet and don't let a single dollar go to penalties or fees due to missed or late payments.
- **Build a Safety Net.** Stuff happens! And if you don't have cash in the bank to handle it when it does, you'll end up going deeper in debt to pay for it. To avoid this, create an emergency fund of at least $1,000 as soon as possible.
- **Confront Your Debt.** Know what you owe. Know how you got in debt in the first place. And figure out how to minimize your costs. Ask your lenders to lower your rates or consider a consolidation loan or balance transfer. Just be careful with this one.
- **Know Your Cash Flow.** Understand what comes in, what goes out, and how you can free up money to put toward your debt.
- **Adjust Your Cash Flow.** Now that you know how to adjust, do it! It's time to make those budget adjustments to free up that debt-destroying extra cash.
- **Pay It Down.** Pay the minimums on all your debts except for one on which you'll pay extra each month. To save on interest costs, attack the highest-rate debts first. To get a bigger emotional boost, attack the smallest balances first. The key is to have a plan and work it!

Take advantage of free and low-cost credit advice. Your installation's family support center may offer free credit counseling. Personal financial counselors can help you establish a budget, restructure your spending and develop a plan to get you out of debt. Consult sources of help in the local community, such as the National Foundation for Credit Counseling (NFCC).

This nonprofit organization can provide you with advice concerning debt management. Visit their website at ***nfcc.org*** or call (800) 388-2227 for more information. So if student loans are, or will be, a part of your future, there are some things you need to know.

A good first step to getting out of debt is to honestly assess where you stand. This worksheet can help you get started.

DEBT WORKSHEET

LENDER	INTEREST RATE	BALANCE	MONTHLY PAYMENT
	TOTAL =	$	$

WORKING WITH A CREDIT COUNSELOR

The services of a nonprofit credit counseling program, such as the Consumer Credit Counseling Service (CCCS), can help get your finances back on track. It's recommended that you only use counseling services affiliated with the National Foundation for Credit Counseling (NFCC).

BENEFITS:

- Creditors might suspend finance fees and late-payment fees when they know you're participating in a CCCS debt management program.
- Some major national creditors view successful completion of a CCCS program as an acceptable credit history. This can help mitigate a negative history on your credit report.
- CCCS counselors will help you develop a budget to determine how much money is available for debt repayment.
- They can negotiate on your behalf with creditors to develop a debt repayment schedule.
- You send a monthly check to CCCS for debt repayment CCCS distributes payments to creditors according to the amounts owed to each.

Getting out of debt isn't always easy. But it can be done if you have a solid game plan and the discipline to stick to it.

KNOW YOUR RIGHTS

MILITARY LENDING ACT

Active Duty, Reserve Component when activated 30 days and longer, and family members enrolled in the Defense Enrollment Eligibility Reporting System (DEERS) are covered by the Military Lending Act. On October 3, 2016 the act went into effect limiting the annual percentage rate for credit to no more than 36 percent covering a number of debts such as payday loans, installment loans and credit cards. For more information visit the Consumer Financial Protection Bureau website at ***consumerfinance.gov*** and search "Military Lending Act".

SERVICEMEMBERS CIVIL RELIEF ACT (SCRA)

SCRA was implemented to protect Active Duty service members (including Guard and Reserve members who are activated) against certain civil actions in the financial management arena. The major included areas are rental agreements, security deposits, evictions, installment contracts, credit card interest rates, mortgages, civil judicial proceedings, and income tax payments. For additional information, visit Military OneSource at ***militaryonesource.mil*** and search "SCRA".

FAIR DEBT COLLECTION PRACTICES ACT

The FDCPA establishes legal protection from abusive debt collection practices. For additional information visit the Consumer Financial Protection Bureau website at ***consumerfinance.gov*** and search "Fair Debt Collection Practices Act".

PERSONAL BANKRUPTCY

Bankruptcy should always be avoided if possible. The two forms of personal bankruptcy are Chapter 13 Reorganization and Chapter 7 Liquidation. If you reach a point where you feel bankruptcy is your only option, consult your legal adviser to determine which is best for you.

A BUDGET CAN HELP WITH DEBT

A realistic budget can help you get out of debt. It can also provide motivation, empowerment, and peace of mind to calm debt anxiety and stress.

FOLLOW THIS 4-STEP PROCESS TO GET YOUR FINANCES ON TRACK AND KEEP THEM THERE

1 KNOW YOUR CURRENT SITUATION

If you're not already there, it's time to get up close and personal with your cash inflows and outflows. You can start by tracking everything coming in and going out so you know what you can change if needed.

For inflows, pay attention to more than just your paycheck. Gifts, tax refunds, rebates, proceeds from selling stuff – if it's money coming in, it all counts.

The same thinking applies for outflows. Out-of-the-ordinary expenses like gifts or new tires for your car need to be accounted for just like recurring outflows.

2 KNOW WHERE YOUR MONEY SHOULD GO

Every situation is different but there are some great budgeting rules that can help you get on the right path. For example, saving and investing should generally be 10 - 15% of pre-tax pay. Taxes will often take up another 20%. Vehicle expenses should be limited to no more than 10%. And housing should generally be no more than 20 - 25%.

3 CREATE A PLAN

Now that you know what your situation really looks like and what you should be doing with your money, it's time to put the two together and make a plan.

Funding your goals should come first. When it comes to cutting back, don't be afraid to make big changes if necessary.

Just be careful not to cut so much that you won't be able to sustain your plan over the long-term.

4 MAKE ADJUSTMENTS

As your life changes, so should your budget in many cases. Be alert to coming changes to both inflows and outflows so that you can make adjustments sooner, rather than later.

A good plan will require frequent adjustments to make sure it evolves with your life.

BUDGET WORKSHEET

MONTH

INFLOWS		YOU	SPOUSE
Basic pay		$	$
Special pay (hazardous duty, flight pay, etc.)			
Housing allowance			
Subsistence allowance			
Total Monthly Gross Income	**[A]**	= $	= $
DEDUCTIONS			
Federal Income Tax Withholding (if applicable)		$	$
State Income Tax Withholding (if applicable)			
FICA - Social Security			
FICA - Medicare			
Other deductions (employer-provided retirement plan contributions, etc.)			
Total Deductions	**[B]**	= $	= $
OTHER INFLOWS (interest, gifts, refunds, etc.)	**[C]**	= $	= $
Total Monthly Net Inflows	**[A-B+C]**	= $	= $

OUTFLOWS	PLANNED	ACTUAL
SAVINGS/INVESTMENTS (target at least 10 - 15% of monthly gross income)		
Emergency fund	$	$
Retirement accounts (IRA, Roth IRA, etc.)		
Other		
DEBT		
Credit cards	$	$
Loans (other than mortgage and autos)		
HOME		
Food	$	$
Rent/Mortgage payment		
Property taxes ($^1/_{12}$ of total annual expense)		
Utilities, cable, satellite, internet, etc.		
Home maintenance		
Furniture		
Phone/Mobile phone		
Property insurance (renters, homeowners)		
CHARITABLE GIVING		
Place of worship	$	$
Other		

BUDGET WORKSHEET

MONTH

OUTFLOWS continued	PLANNED	ACTUAL
INSURANCE		
Health	$	$
Disability		
Life (SGLI, spouse's group plan, personally owned, etc.)		
Long-term care		
EDUCATION		
Tuition	$	$
Room/Board/Travel		
Books/School supplies/Uniforms		
TRANSPORTATION		
Vehicle payment	$	$
Auto insurance		
Gasoline/Parking/Tolls/Public transportation		
Vehicle maintenance		
Other (Registration/License fees, $\frac{1}{12}$ of total annual expense)		
PERSONAL		
Clothing	$	$
Laundry/Dry cleaning		
Grooming (hair care, toiletries, etc.)		
Child care (baby sitters, child care center)		
RECREATION/ENTERTAINMENT		
Vacations ($\frac{1}{12}$ of total annual expense)	$	$
Entertainment/Dining out		
Hobbies (for example, golf or tennis equipment and fees)		
Club fees/Organization dues		
Other		
TOTAL MONTHLY OUTFLOWS	= $	= $

CALCULATE MONTHLY CASH FLOW	PLANNED	ACTUAL
Total Monthly Net Inflows	$	$
Less Total Monthly Outflows	- $	- $
Net Cash Flow (Deficit)*	= $	= $

** If your net cash flow is positive, you can save more for emergencies or other financial goals. If it's negative, you will have to cut outflows or increase inflows (by taking a second job, for example).*

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