Ask the Manilla Expert: What's the Best Way to Get Out of Debt?

By Kimberly Rotter

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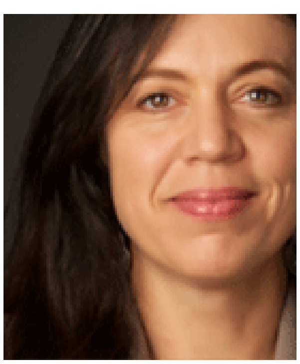

Manilla Q&A with Debt Management Expert Kimberly Rotter

Question:

[My wife and I] are going to try to get out of debt. Our plan is to pay as much as humanly possible on our credit card to get rid of that debt, then once it is paid off use that same money to pay off another debt, like my car. Does that sound like a good plan? I am [not behind on] the payments. I'm just tired of shelling out $2,200 a month on debt.

Answer:

In a nutshell, yes, it sounds like a great plan. This reader may not realize it yet, but he's talking about a debt repayment strategy called "snowballing."

Snowballing payments
Snowballing means that as you pay off each debt, you apply even more money to the payment on the next debt. In this manner, the monthly payment you make toward your target debt grows each time an account is paid off and each debt is paid off at a faster rate than the one before.

Specifically, you would make the minimum payments on all of your debt except the one you're focused on (the **target debt**). Then, when the target debt is paid off, debt No. 2 becomes your target debt. Take all of the money you had in your budget for debt No. 1′s monthly payment and apply it to the monthly payment for debt No. 2 *in addition to the minimum payment you were already making on that debt*. When debt No. 2 is paid off, take all of the money from the first debt payment and all of the money from the second debt payment and add it to the minimum payment for debt No. 3, the new target debt. The size of the payment grows like a snowball rolling down a hill.

Choosing which debt to pay off first is entirely up to the debtor, but there are two main schools of thought. Each has its advantages.

Option A: High interest first
If your primary concern is the financial bottom line, you should pay off the debt with the highest interest rate first. The upside is that you will minimize the amount you pay in total interest charges. The downside is that if the most expensive debt is quite large, it could be a long time before it's paid off and you could become discouraged or lax in the meantime.

Option B: Smallest balance first
For many of us, positive reinforcement inspires us to continue, even in the face of difficulty. Attaining one goal is excellent motivation to work toward the next. When you tackle the smallest debt first, you reach your first goal sooner. The sense of accomplishment is the payoff for the austerity measures you've taken to get out of debt, and it pushes you to work toward your next goal.

It doesn't matter too much which approach you take, so long as you stick with it.

Saving money with zero percent interest rates
If you are very savvy with your finances and did not fall into debt because of irresponsible use of credit cards, you can also try the introductory rate shuffle to save on interest charges. You'll have to first get your balances down to a level healthy enough that you will qualify for the credit card offers. Once you receive a zero percent card, transfer higher interest balances over to it.

This strategy won't work for certain debtors:

- Consumers with high balances usually won't qualify for zero percent offers even with a history of on-time payments
- Consumers with a history of late or missed payments definitely will not qualify

- People who have a history of charging more than they can afford to pay off when the statement arrives often fall into the trap of simply charging up one more credit card
- If a consumer is not disciplined with the repayment plan, he or she can end up with an even higher interest rate once the introductory rate expires, or simply with a missed opportunity to reduce balances quickly while the interest is free

Cash flow and budget
Another issue you must contend with is your budget. You must have positive cash flow for any debt repayment plan to work. In other words, you must be able to get your expenses down so that at least a little bit of money is left over each month and can be applied toward debt. If your expenses exceed your income each month and you're putting groceries or other everyday purchases on a credit card, no debt repayment plan can succeed. Indeed, negative cash flow is a strong indicator that bankruptcy might be your most viable option.

Help and guidance
Visit SharpenToday.org and use the free tools to assess your financial health. If your debt concerns you or you're already overwhelmed, talk to a credit counselor about your options. Free and low-cost help from certified professionals is available through the National Foundation for Credit Counseling. You will not be turned away because of inability to pay.

Do you have a question you'd like to ask a Manilla expert? Send us an email.

Kimberly Rotter is a writer and small-business owner. She is a featured contributor on Credit Sesame and writes professionally in several industries, including finance, education, the environment, and health and wellness. Kimberly holds an MBA and has successfully founded and operated two small businesses – a clock company in the late 1990s and a writing and editing service, currently in operation. She is a wife and mom, and enjoys researching and writing about topics that affect parents and families. She always has a new venture up her sleeve and is currently stockpiling content related to preschool and elementary education options. Connect with Kimberly on LinkedIn, Google+ and Facebook.