A step-by-step guide to paying off your debt

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Introduction

According to the World Bank, South Africans are the biggest borrowers in the world, with 86% of the population in debt. The National Credit Regulator believes that 10.3 million South African consumers struggle to make their monthly debt repayments.

At Truth About Money, we know that these consumers are desperate to learn not only how to get out of debt but also how to stay out of it. This eBook was written in response to this demand for advice and information. It guides consumers through the process of paying off their debt, from choosing a debt repayment method to contacting their creditors and making repayment plans. It also deals with debt review, or blacklisting, and takes a close look at debt consolidation loans. Lastly it teaches consumers how to budget and save and invest to stay out of debt.

We hope that this eBook will motivate you to take your first step towards a debt-free and financially fit life.
Good luck!

The Truth About Money Team.

Truth About Money

Truth About Money is a 1Life initiative that offers a financial education course, debt management and estate and wills services to all successful online applicants at no charge.

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About the author

Dineo Tsamela is a business and personal finance writer. She's also the founder of Piggie Banker, a personal finance education site. Her goal is to make financial literacy simple and accessible to those who need it, so they can avoid the mistakes she has made.

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Chapter 1: Budgeting

More than 11-million credit active South African's are over-indebted and struggle to keep up with monthly repayments. The purpose of these articles is to help consumers figure out how to best approach the challenging task of getting rid of their debt.

The series will cover essential steps in the debt recovery process such as budgeting and handling creditors when your debt exceeds your income as well as important information related to getting assistance if your debt has completely spiralled out of control. If you're trying to figure out how to begin clearing your debt, then budgeting is the first step. It plays a vital role in helping you assess where your money is going and how you can keep up with monthly payments to your creditors.

Learn the 50/20/30 Principle

Learning how to categorise costs and determine what constitutes needs and wants is important. Use the 50/20/30 principle as a guideline to help you put together a workable budget and categorise your spending in order of importance.

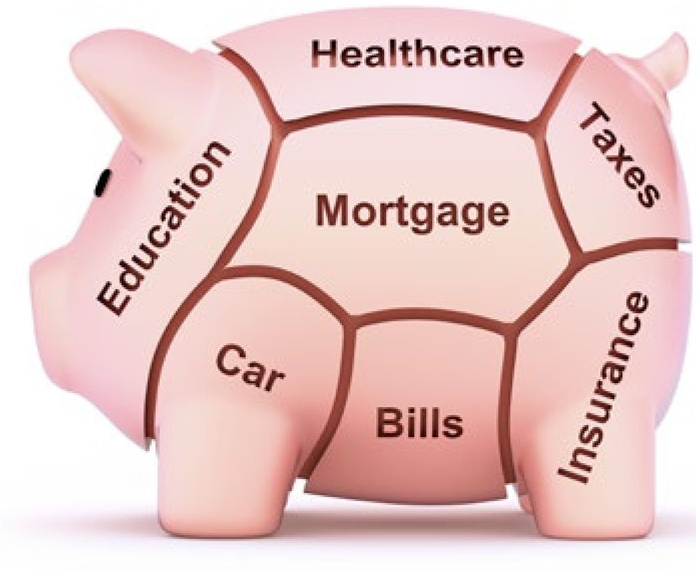
Basically the 50/20/30 principle means that 50% of your income should go to essential expenses, 20% towards your financial nest egg, and the remaining 30% to other lifestyle expenses.

50% essential expenses

Half of your income should go to essential expenses like your rent or bond payments, transport costs, groceries, water and electricity and other utility costs. Car and home insurance, medical aid and life cover fall under this category as well.

20% debt, savings and investments

One fifth of your earnings should go towards debt repayment and savings and investments, which include your retirement, an emergency fund and any short-term savings goals, for example a holiday or new car.



30% lifestyle expenses

The last 30% of your income should go towards 'wants'. These include DSTV/Netflix/ShowMax and cellphone contracts as well as entertainment, gym and holiday savings etc.

The 50/20/30 principle isn't a one size fits all formula; but you can use it as a guideline when evaluating your budget and spending to see where you need to cut down. It's also very important that you don't confuse essential expenses with lifestyle expenses. The two aren't the same!

Drawing up a monthly budget

Drawing up a monthly budget is the next step in organising your finances. Budgets are important in the debt repayment process as they give you a clear picture of where your money is going. You'll also be able to see what costs need to be cut in order for you to keep up with your debt repayments and how much you can afford to pay to each of your creditors.

Step 1: Organise your paperwork:

Putting together an effective budget is about knowing the full extent of your monthly expenses including your outstanding debt as well as how much you're contributing towards savings and investments. You will need to gather together the following documents:

- All your bank and credit card statements, store account statements, personal loan and revolving loan statements, medical aid, car payments, both car and household insurance, household bills, payslips and invoices (from secondary income sources).
- Records of any contributions towards investments/retirement, savings, life cover, etc.

Step 2: Find a budgeting tool

- Get a notebook or, if you want to have a more automated budget, dedicate an excel spreadsheet to your budgeting.

FREE DOWNLOAD: BUDGET SPREADSHEET

You can use budget planning tools such as our budgeting spreadsheet to help you draw up and manage your budget.

Step 3: Know how much is coming in

- Record your monthly income, including extra sources of income, for example grants, child support, rental from investment properties etc.

Step 4: How much is going out

List the following expenses and payments:

- Your monthly expenses like rent/ bond payments, car repayments, medical aid, school fees, transport and entertainment.
- Your debt repayments such as personal loans, credit card, clothing and store accounts and friends or family members you owe money to.
- Contributions to savings and investments.
- If you have annual expenses to account for make note of them so that you can incorporate them into your monthly budget. You can plan for these expenses by saving towards them every month.

  Total all expenses and then divide them by 12 to get a rough idea of how much you should be saving monthly. Annual expenses could include expenses such as pet vaccinations, staff bonuses, seasonal wardrobe shopping, birthdays, TV and car licences and school supplies.
- You should also set money aside every month to start savings towards an emergency fund. This fund should cover those unplanned expenses such as medical bills that are not covered by medical aid, speeding fines or unexpected vehicle or home repairs that aren't covered by insurance.

Don't forget the 50/20/30 principle! When listing your monthly expenses, slot each expense under one of the categories. Check that your essential expenses, debt and savings and lifestyle expenses are falling roughly within the 50%, 20% and 30% guidelines.

Step 5: Tackling your debt repayments

If your monthly spending and debt repayments exceed your monthly income, look at what you can cut under the lifestyle expenses, such as putting off that family holiday, going out less or cancelling magazine subscriptions. Then look at what you can cut under essential expenses, for example cheaper accommodation or a cheaper car, saving on your grocery bill or finding cheaper short-term insurance. Decide what you can cut out and adjust your budget accordingly.

If you still fall short, then it may be time to contact your creditors to negotiate payment terms that suit your budget. Remember if you regularly skip payments you make it difficult for creditors to come to your aid, and you open yourself up to legal action. Missing payments also has an impact on your credit score.

We will discuss how to contact your creditors in chapter 3 of our series.

FAST BUDGETING TIPS

- **Be honest with yourself:** Be truthful about how much debt you're in, and prioritise these repayments over lifestyle wants.
- **Be realistic:** Don't budget for what you hope for, budget for what's most likely to happen.
- **The little things add up:** Don't gloss over 'small' expenses because you think they're insignificant. Those 'negligible' R50 and R80 purchases made here and there can easily become R2,000 that could go towards paying off your debt.
- **Review and adjust:** It helps to review your budget often and make adjustments where necessary.
- **Discipline is everything:** Your budget will not work for you unless you make an effort to stick to it. Having a beautiful and well organised budget is pointless if you don't follow through.
- **Don't overlook the power of automation:** Use stop orders and make debit order arrangements work in your favour so that payments are made on time and you don't have to remind yourself to make them.

Chapter 2: What method will you use to pay off your debt?

Paying off debt

Now that you've drawn up your budget and worked out how much of your income you can afford to put towards your debt, it's time to figure out how you're going to go about eradicating that debt.

There are two methods you can use to get rid of debt: the snowball and the avalanche method.

The snowball method

Using the snowball method you pay off your debt by balance, starting with the smallest debt. This method works well if you need to stay motivated to keep blitzing that debt.

How it works

- Arrange your debt by balance owed, beginning with the smallest.
- Then allocate funds to pay the minimum due on each account.
- For the smallest account, see how much you can add to the minimum payment so that you eliminate it as soon as possible.
- Once that debt is paid off (don't forget to close it with your creditors) you can move on to the next debt.

An example

Say you have five accounts with the following balances:

R 1 000 (min payment R100)
R 2 500 (min payment R250)
R 5 000 (min payment R500)
R 10 000 (min payment R1 000)
R 12,000 (min payment R1 000)

You have allocated R 3,000 to go towards paying off your debt in total. Your total minimum debt payments come to R2,850 leaving you with R150 to contribute towards the smallest debt.

For four months your instalment for the R1,000 debt will therefore be R250. When it is paid off, you will defer this R250 payment towards paying off your R2,500 debt until that is paid up in full.

Each time you pay off one debt, you have a little more money to contribute towards paying off the next outstanding amount.

FREE DOWNLOAD: SNOWBALL DEBT REPAYMENT SPREADSHEET

Our snowball debt repayment spreadsheet will help you work out how long it'll take you to pay off your debt using this method. You'll see we've used the figures in the example below to show you how it would work. Create your own spreadsheet by adding more rows or accounts and play with the numbers till you have a solid debt repayment map.

THE SNOWBALL METHOD

	Account 1	Account 2	Account 3	Account 4	Account 5	Monthly Total
January	R 250,00	R 250,00	R 500,00	R 1 000,00	R 1 000,00	R 3 000,00
February	R 250,00	R 250,00	R 500,00	R 1 000,00	R 1 000,00	R 3 000,00
March	R 250,00	R 250,00	R 500,00	R 1 000,00	R 1 000,00	R 3 000,00
April	R 250,00	R 250,00	R 500,00	R 1 000,00	R 1 000,00	R 3 000,00
May	R 0,00	R 500,00	R 500,00	R 1 000,00	R 1 000,00	R 3 000,00
June	R 0,00	R 500,00	R 500,00	R 1 000,00	R 1 000,00	R 3 000,00
July	R 0,00	R 500,00	R 500,00	R 1 000,00	R 1 000,00	R 3 000,00
August	R 0,00	R 0,00	R 1 000,00	R 1 000,00	R 1 000,00	R 3 000,00
September	R 0,00	R 0,00	R 500,00	R 1 500,00	R 1 000,00	R 3 000,00
October	R 0,00	R 0,00	R 0,00	R 500,00	R 2 500,00	R 3 000,00
November	R 0,00	R 0,00	R 0,00	R 0,00	R 500,00	R 500,00
December	R 0,00	R 0,00	R 0,00	R 0,00	R 0,00	R 0,00
Acc Total	**R 1 000,00**	**R 2 500,00**	**R 5 000,00**	**R 10 000,00**	**R 12 000,00**	**R 30 500,00**

The avalanche method

The avalanche method focuses on paying off the debt with the highest interest first. This method is the most cost effective, efficient and fastest way to get out of debt but requires a lot more discipline.

How it works

- Arrange your debt from highest interest to lowest charged.
- Allocate funds to pay the minimum due on each account.
- Allocate extra available cash to the account with the highest interest rate and chip away at it until it's done.

Remember that interest is charged on your outstanding balance so reducing your balance sooner, reduces the amount of interest you pay.

What works best for you?

From a purely financial standpoint, the avalanche method will save you the most money and time. However, if you're unlikely to find the motivation to stick to the avalanche method, then the snowball method will probably work better, at least until you've gained momentum and feel confident enough to tackle your debt with focus and discipline.

Note: You don't have to limit yourself to one method. A combination of both could mean you stay motivated by paying your debt off from the smallest to largest while simultaneously getting rid of the high interest debt.

If you find that you are having difficulty balancing your budget after having worked out which method works best for you and you've cut expenses where possible, then it's time to call up your creditors to negotiate easier payment terms until you've slashed a balance, or three!

Chapter 3: Contacting your credit provider and making repayment plans

Contact your credit provider

In previous chapters we covered how to draw up a budget and helped you to choose a debt repayment method. In this chapter we'll give you tips on how to negotiate easier payment terms with your creditors if your budget revealed that you are over indebted - which means your expenses exceeded your income and you cannot meet all your financial obligations and keep up with monthly repayments.

Contacting your creditors

You can either visit your creditors in person or phone them and try to negotiate easier payment terms. Creditors are usually open to negotiating easier payment terms if you're in a tight position. You can present the figure you're able to pay, and increase your instalment as you pay off other accounts.

- **Act early:** deal with your accounts before they're handed over. It's easier and cheaper to deal directly with creditors than with debt collection agencies.
- **Be honest and polite:** explain your financial position. You don't have to go into detail, but a short explanation should suffice. Don't make it seem as if you're doing your creditors a favour by making a payment arrangement and don't be rude.

- **Understand what you're getting into:** how will interest be charged under the new payment arrangement? What is the final amount you will have paid by the end of the payment term? Don't be afraid to ask questions!
- **Take notes:** and make sure you get a reference number and name for every call you make.
- **Always ask for proof in writing:** whether it's a confirmation email or a statement on the company's letterhead, for you own protection you need to make sure you have something in writing that confirms the new arrangement.

Handed over, now what? Dealing with agencies

If any of your accounts have been handed over, you'll need to contact the agency handling your account and deal with them. Be warned that most agencies charge for admin, SMS sending, inbound and outbound calls and other small hidden fees that end up adding a huge chunk to your debt. An outbound call could cost you about R20 per call, if you don't respond. The longer the call, the higher the fee. Being proactive and making a payment arrangement; means you avoid carrying unnecessary costs.

What if I want to settle my account in full?

You can negotiate a settlement discount with creditors if you happen to receive a large sum of money and want to pay off one debt, or all your debt in full.

You'll need to call the creditors and find out how much of a discount they're willing to give you and how long it's valid for. The sooner you settle, the better. It is important that you get a written confirmation that the account has been settled in full and closed.

Always make sure that the account is closed as well, and ask for written confirmation. Keep all correspondence in a safe place.

Still need help?

If you have done a budget, chosen a debt repayment method and contacted your creditors to arrange manageable monthly repayments, and you still cannot pay what you owe every month, then it might be time to consider debt consolidation or even debt review. In our next chapters we will discuss the pros and cons of these options.

Chapter 4: Debt consolidation

As out last chapter showed, you can work your way out of debt with a little discipline, patience and some smart tools.

Despite this, there will always be a quick fix that might seem like a good choice but with a little investigation, you'll find it is not a solution to your problems. This is usually the case with consolidated loans.

A consolidated loan is a loan that is taken out to pay off smaller loans, or other types of debt, thus reducing the number of payments made in a month, as well as the amount paid monthly. People who find themselves under immense pressure because of debt, will often seek out consolidated loans to help ease the burden of their monthly obligations.

In most cases, financial institutions will grant clients personal loans and it becomes the client's responsibility to ensure that they make payments to creditors. Some financial institutions will however request that you bring proof of all your outstanding debt and they will pay it off on your behalf.

The benefits of consolidated loans

- All your outstanding debt is paid off so you no longer have to deal with individual creditors.
- You only have one loan to pay off.
- There's a little more disposable income available in your budget.

While a consolidated loan might seem like a good idea, there are downsides to them that you need to consider before taking the leap.

The disadvantages of consolidated loans

- You may pay extra in administrative costs.
- The interest rate might be lower than the average rate of your current debt but a longer term means you'll pay more in effective interest.
- It doesn't get rid of your debt, it's simply the same debt in another form.

Before you sign up for a consolidated loan, calculate how much interest you will pay on your current debt and compare this amount with the interest you'd be paying if you take on a consolidated loan.

Bonds and interest

Using your bond as a tool for paying off smaller debt might seem like a smart solution, but even with a lower interest rate you'll find that a debt you'd be paying over 3 years is stretched out over twenty years and that makes no sense because you'll be paying a lot more in interest.

For example, paying a 23% interest rate over 3 years will cost much less than paying a 10% interest rate over 20 years.

Can it work for you?

Debt consolidation requires a lot of self discipline and some people fail to control their debt even after going this route.

They take on a consolidated loan, pay off their debt and take on more credit, thinking they're going to be able to manage now that their previous multiple instalments have been reduced to just one.

One way to avoid this is to approach an institution that'll settle the loan directly with your creditors and you deal with paying off the loan to them. It's also a good idea to close the accounts once they've been settled to avoid backtracking.

If you consider a consolidated loan you should compare the interest rates and admin costs that are associated with the loan with your current debt before you make your decision.

Change your behaviour

Remember that it's important that you stamp out the behaviour that got you into a place of financial distress in the first place. Trying to get rid of debt by taking on more debt does not work in your favour.

Chapter 5: Debt review

Debt review

In the last chapter we discussed the option of debt consolidation and the implications it has on your finances if not used properly.

We saw that a consolidation loan is not necessarily a bad thing, however one has to weigh the cost of getting a consolidated loan against the cost of settling current debt in order to ensure that it is a cost effective way to eliminate debt.

But what happens when you can't even turn to debt consolidation because you're so deep in debt that no one wants to extend credit to you?

When matters have escalated to this level you need to consult with debt counsellors to negotiate easier payment terms with your creditors.

How does the debt counselling process work?

Once a person decides to undergo debt review, they approach a debt counsellor who will assess whether the person is indeed over-indebted.

If you are over-indebted, your counsellor will inform the credit providers that you owe and the various credit bureaus that you are under debt review.

Once your debt counsellor has requested and received a certificate of balance from each of your credit providers, both you and your counsellor will map out a debt repayment plan that fits into your budget.

Your debt counsellor will approach credit providers with the debt repayment plan that you drafted and negotiate easier payment terms, such as lower instalments and/or interest rates on your behalf.

For the process to continue beyond this, your credit providers must agree with the new payment terms.

Once this is settled, your debt counsellor will approach the court to make your new payment plan an official court order.

The court order is for your own protection so that creditors do not institute any legal action against you.

Costs

Application fee: A R50 application fee is payable to the court. If your application for debt counselling is rejected by the court, you'll have to pay a R300 rejection fee. If your application is approved then you will be charged a restructuring fee by your debt counsellor that is equivalent to the first instalment of the debt repayment plan, although this amount cannot exceed R6 000 (excluding VAT).

Consent fee: In the 2nd month of debt counselling, you'll have to pay a legal fee of R750 so that your counsellor can get a consent order for your debt repayment plan. This cost is not part of the repayment plan.

Aftercare fee: You'll then have to pay a monthly aftercare fee of 5% of your monthly instalment for the first 24 months of your repayment. Thereafter, you'll pay a 3% aftercare fee until you've finished paying off all your debt. The aftercare fee cannot exceed R400. This fee is included in your monthly repayment.

Withdrawal fee: If, for whatever reason, you choose to withdraw from the debt review process you will be charged a fee that is the equivalent of 75% of your restructuring fee.

Withdrawing from the debt review process also means that the protection you have under debt review is lifted and court judgements can be instituted against you.

You'll also have to pay for any other legal costs that result from the process. These are usually worked into your monthly payments but you need to confirm this with the debt collection agency.

A warning on debt review

Before deciding to go down this route, make sure that you have tried negotiating with your creditors, worked on a debt repayment plan, tried to work out how to earn extra income and exhausted every single other possible avenue.

If you are under debt review, you are not able to make use of other credit facilities until all your debt is paid up and you're no longer undergoing debt counselling. Depending on how long it takes to finish paying off all your debt, it could be years before you're able to access credit again.

Your counsellor might negotiate lower instalments and interest rates but you'll be paying over a longer term so a lower interest rate might still end up being a bigger cost over this extended period of time.

Once you have finished paying off all your debt your counsellor will cancel the process and you will have access to credit again.

Finding a debt counsellor

It's important that you approach a reputable debt collection agency that is registered with the National Credit Regulator (NCR). You can find a list of registered debt counselling agencies by visiting www.ncr.co.za.

You should also verify that the debt counselling agency has the following:

- A registration number, which you should be able to verify with the NCR. They should also be a part of the Debt Counsellors Association.
- An attorney to represent you in court. Follow up to make sure that you'll get fair and professional representation for your case.
- Fair fees. Is the fee structure in line with what the NCR has set out? If you suspect that you're being ripped off, get a second opinion or approach the NCR for assistance.
- An accredited payment distribution agency (PDA). Once your debt repayment plan is approved, no payments should be made directly to the debt counsellor. The NCR website will have more information on which PDAs are currently authorised to facilitate payments.

Chapter 6: Differentiating between good & bad debt

Good and bad debt

We've discussed how to come to terms with your debt, how to communicate with creditors, debt repayment methods as well as debt relief methods, such as consolidated loans and debt counselling, that are available for you if you are too indebted to cope on your own

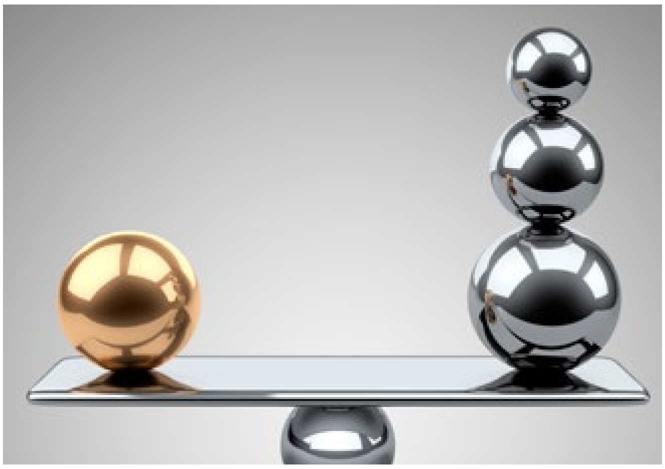
However, credit isn't necessarily a bad thing. You might need it to buy big ticket items such as a car or house. There are very few people who can afford to pay for such items using cash.

This is why you need to be able to differentiate between good and bad debt, so that you can avoid getting into unnecessary consumer debt.

What is good debt?

Good debt can be used to finance an asset or item that will either appreciate in value or beget more value for you. A car loan is considered good debt because it contributes to your livelihood by getting you to and from work. However, good debt doesn't only apply to houses and cars.

Student loans can also be a form of good debt, because students hope that the value of their education will help them earn enough to pay off the loan and reap other benefits that come with the qualification.



Someone who wants to start a business might take out a business loan in the hopes that their business will generate enough revenue, for them to be able to payoff the capital loan amount borrowed and the interest they were charged to grow a profitable business.

Good debt brings value beyond the cost of acquiring the debt.

What is bad debt?

Bad debt is debt that neither increases wealth nor does it have any lasting value.

For example, buying home appliances with a 12-month warranty and paying for them over a 24 or 36-month period.

By the time you finish paying off the item you'll probably need to buy a replacement, which means you've not only spent money paying for the item and interest, but now you have to start with payments again because you need to replace the old appliance with a new one.

Bad debt can include:

- Clothing accounts
- Furniture accounts
- Revolving, high interest credit such as pay day loans, or temporary loans that are payable in a month's time.
- Personal loans (taken for holidays, for example)
- Credit cards where only the minimum instalment is paid and the card is always in the red

This list is not exhaustive as bad debt can manifest itself in many other ways.

Can you really afford it?

If you're struggling to decide whether or not to pay for something using credit, always consider the value of the return.

Ask yourself the following:

- Is this purchase beneficial?
- Will I be able to measure the value it brings me in real terms?
- Can I save up for it and see whether I can afford it in 6 months' time?

Apart from big ticket items such as a car and a house, you'll find that most of the time you can save up for the item you want.

Chapter 7: How saving & investing can help you stay out of debt

The most important thing once you've worked your way out of debt is making sure that you stay out of debt.

Staying out of debt can be difficult because of the many situations we often find ourselves in that require some form of credit.

One of the best ways to stay out of debt is to focus on building your savings and investments. Having an emergency fund as well as short, medium and long-term savings and investments is important if you want to ensure that you have a solid financial foundation.

An emergency fund

You should have an emergency savings fund that you can turn to on rainy days.

An emergency fund can be used for anything from a broken microwave or a burst geyser to an unexpected medical cost that your medical aid may not cover. You can also set up an emergency fund to save a few months of your salary in case you find yourself without a job. Your emergency savings fund could be what prevents you from financial ruin.

Where should your emergency fund go?

Think about ease of access when you pick a savings account to house your emergency fund. You'll want to scrutinise the account's structure–i.e. what the notice period is, the interest rates offered and the investment period that may be applicable as well as account fees.

You should also look at the minimum balance requirement. Different banks will offer different products and, depending on the conditions around minimum balances, you'll also be charged different interest rates.

Saving in the short term (up to 3 years)

Short-term savings could include saving to replace small household items or for your next holiday.

You can look at savings vehicles such as:

- Call accounts
- Savings accounts
- Money market accounts
- Fixed deposit accounts

Note: You don't want to expose your short term savings to risk because you might need to access that money at any given time and you want your capital to be guaranteed.

A capital guaranteed, low-interest bank account, as listed above, is therefore your best option. Be sure to shop around so that you can get the 'best value for money' account.

Medium term saving (3 to 5 years)

Within the 3-5 year range of saving, you're not too concerned about having immediate access to your funds. You can therefore make time and compound interest work in your favour.

You can use medium-term savings to put money aside for buying a car or saving for a down payment on a house.

You may want to consider the following savings or investment vehicles:

- Money market accounts and fixed-term deposit accounts for a longer term (i.e. 3+ years)
- Unit trusts
- Exchange traded funds (ETFs)
- Retail bonds

Note: ETFs, unit trusts and endowments are all exposed to market fluctuations, so be cautious when you withdraw your funds. Although they're not considered high-risk investment products, market conditions will have an impact on the value of your investment at any given time.

Long-term investing (over 5 years)

For long-term investing, you should consider more aggressive, high-risk investment vehicles because the time frame allows you to ride out market movements.

However, it's a good idea to speak to a financial planner about the best long-term options, particularly if you're saving for retirement or your children's education.

You should also consider adding tax-free investment products to your long-term investment strategy. The added tax-free benefit could mean much greater returns over a 10, 15 or 20-year period.

Conclusion

We hope that you have found this information useful and that you have started the journey to paying off your debt and living debt free!

If you would like to learn more about how to manage your finances or to apply for debt review, please visit *www.truthaboutmoney.co.za*