



Breaking Free of the Credit Trap

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What is a Credit Trap?

Here is a typical example of how a credit trap happens:

As you progress through life, you inevitably use credit of some kind – a vehicle loan, a mortgage, a credit card or other type of loan. Once you start getting credit, you have more and more opportunities to get credit. Your bank offers you a credit card or line of credit. You get offers in the mail. You get a card for emergencies and say that you will not use it for anything else. You use just a bit more than expected, and all of a sudden you can't pay it off in full each month. You start making monthly payments. Emergencies arise – car repairs, a death in the family, an illness, job interruption...any number of things, and you don't have the savings or cash flow to handle it, so you rely on your credit. It builds up a bit more. The payments increase. And so it goes. Welcome to the credit trap!

Steps you can take to break the Credit Trap

1. **Recognize the Warning Signs!** - There are some very distinct signs that you are heading down the wrong road financially.

Early warning signs include:

- Requesting credit limits be increased on a regular basis
- Impulse buying
- Don't know your actual monthly expenses
- Using credit cards as a source of cash rather than a convenience
- Subscribing for unnecessary credit cards
- Being declined credit by your financial institution

The more obvious warning signs are such things as:

- collection calls / notices
- Using credit to create income
- Stalling one creditor to pay another
- No savings
- Not paying off full balances each month
- No money left before payday / use of payday loans
- Consolidating loans (ie. remortgaging)

2. Define your relationship with Credit - Do you control credit or does credit control you?

When is credit controlling you?

- You have too many cards
- You're using credit to supplement your income
- Using credit to buy a house/car/etc. that you cannot afford
- You "need" credit to live comfortably
- You're relying on credit to meet occasional and unexpected expenses vs. savings
- Using credit to keep up with the Joneses'

When are you controlling credit?

- You pay off your revolving credit in full each month
- You leverage credit to make/save money/interest
- Credit to invest
- Use low interest credit for borrowing needs (ie. Mortgage/line of credit)

3. Consider ways to reduce the interest rate you pay

- Check your credit report and your credit score - a strong credit score gives you leverage in negotiation a low interest rate.
- Shop around for the best rate – don't necessarily sign your automatic mortgage renewal, ask if the bank can do a better rate and call around to rate compare. (Caution: be careful of getting too many checks on your credit report, as this could drop your credit score).
- Ask! - I know, it seems simple enough, but it is amazing how many people accept the rate they are given and don't ask for another rate. Ask if the loan/credit card company can do better. Once you have had a credit account for a while (specifically credit cards), call and ask if they can offer you a better rate.
- Focus your energy and resources on paying off one credit account at a time Focus your energy on paying off one card. Why? When you pay off one of your credit cards, you feel like you have accomplished something. AND...the credit card company, who wants you to use credit, will offer you specials to entice you to use it again, like a low or no interest period...or a reduced interest rate on balance transfers. You can then transfer the balance from a higher interest credit card to the lower interest card and focus on paying that one off.

Steps you can take immediately to help break your dependency on credit:

1. Determine what zone you are living in - There are three zones: Survival, Comfort and Desired. You want to know where you should be living is based on your current income and you want to know where you are living based on your current income. If you are living in a zone that your income does not support your income, you are likely using credit to support your living.

2. Be aware of your spending - If I could give just one piece of advice, in almost every instance, it would be to find a simple strategy to track where your money goes. Information is power! This gives you valuable information so that you can make good decisions about where you want your hard-earned dollars to go.
3. Answer the four questions:
 - a. **Where do I think I am?** (This is the first step, writing down what you THINK your income is and what you THINK your expenses are. When you do this exercise, if it looks like you spend more than you make, sit up, take notice, and move to the second question. If it looks like you have money left, don't get too comfortable, move to the second question) 😊
 - b. **Where am I really?** (This is where you actually track and find out what's actually happening).
 - c. **Where do I want to be?** (It is so important to have some idea of where you want to be. This is your 'driving force' to make changes
 - d. **How am I doing?** (Equally as important is checking in periodically to assess how you are doing. Things often don't go as smoothly as planned. Don't seat it. Just re-evaluate and adjust your plan accordingly).

What if you are in a real mess and none of the above works?

The above are all great early and even later intervention tips and techniques, and fall under the "budget yourself out of debt" category. But sometimes there simply is not enough cash flow to survive AND pay your debt. In those instances, more drastic steps may need to be taken.

The following is a short list of suggestions on what to do if this adequately describes your current reality:

Explore refinancing options:

- This is only an option if you can reduce your monthly payments enough to still live comfortably so that you are not relying on credit when situations arise that outside of normal day to date expenses.
- Refinancing is tied directly to your credit score – both the ability to qualify for a refinance and the rate that you pay, as discussed previously.
- This is often a long-term solution and not a quick fix.

Explore Debt Reductions Strategies:

Unlike the above, in this set of options you have resigned yourself to the fact that there is no way you can get yourself out of this on your own. You have tried all of the "budget yourself out of debt" options and have explored the 'Refinancing options', and none of them are working for you. You are on the verge of having your accounts go into default and to collections, or they are already there. Once you make the decision to proceed to "Debt Reduction" you are going to impact your credit rating/credit score...which may, or may not be, the end of the world, as I discussed in my previous teleseminar.

The four ways you can settle your debt are as follows. (My recommendation is that if you are at this point you seek professional advice to explore ALL of them so that you can make the decision that's best for you.)

- **Offer your creditors a settlement** – this sometimes works and often doesn't. Trying to get your creditors to accept a settlement is challenging if it is not a lump-sum settlement as there is no guarantee you will honor the amount. Creditors often want a reputable third party to facilitate the settlement on your behalf.
- **Credit Counselling** – there are several independent Credit Counselling Companies that will step in, contact your creditors and make a settlement on your behalf. This industry is not regulated and some are more reputable than others, so I definitely recommend doing your homework and ask for a referral if you go this route.
- **Consumer Proposal** – a Trustee in Bankruptcy or Administrator of a Consumer Proposal licensed and regulated, contact your creditors to make a settlement offer that ensures both yours and your creditors' rights are protected.
- **Bankruptcy** – Bankruptcy makes the bottom of the list for a reason. You want to explore all options before considering bankruptcy. In some instances, it is your only option or potentially the best one. The Bankruptcy process is also administered by a license regulated Trustee in Bankruptcy who ensures the rights of all parties are honored and protected.

As always, when we talk about finances, money, credit and options, the above is a guideline of information meant to give you some guidance. Often the option that best for you is dependent on your own personal circumstances.

Wishing you Happy, Healthy Finances!

Mary Ann Marriott
aka Dr Debt