Dec 28: Rise to the challenge, and get debt under control: Janet Gray

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In this third of a four-part series, Save with SPP talks to Janet Gray, CFP, of Money Coaches Canada about the stress and worry of debt, and how to get it under control.

There's no doubt, says Janet Gray, CFP, of Money Coaches Canada, that debt is a "nemesis" for many people today. It causes "stress, worry, anxiety, hopelessness," and people can "just get ground down by it," she tells Save with SPP.

"There's no simple way to get out of it; it can seem like quicksand. Many users feel stuck," she explains.

These days, the sources of debt she helps clients battle include "consumer debt and credit cards, and I'll include variable rate mortgages and lines of credit too," she says.

Credit cards, she says are the worst “because they are toxic,” and can carry very high interest rates in the 19 to 21 per cent rate. “If you miss even the minimum payment, the credit card interest rates will go even higher,” she warns. Or, worse, you could get your card cancelled and still owe all the money and interest.

While credit can lead you into trouble, it is a bit of a “necessary evil,” she explains. You need to establish credit so you have a borrowing record, so that you can qualify for things like car loans and mortgages, she says. So having bad credit can make those dreams less possible – it can take two or more years to repair a bad credit score.

We hear that credit cards work well for those who are able to pay off their balance each month, and Gray states that it’s about 70 per cent of Canadians who fully pay their balance monthly.

But many people feel that just paying the minimum amount on a credit card is good enough, when all it means is that you are mostly paying the interest down, but not the principal. They see the credit card as money, rather than a source of debt, she explains. “For some people, a credit card is the only cash flow they have,” she explains.

So, if you are barely able to cover all your minimum payments each month, how do you get out of debt?

“First,” says Gray, “you have to recognize that it is going to be a challenge – and will take some time.”

Next, look at each individual debt that you have. There are several ways to attack the debt.

The “avalanche” method involves paying extra on your highest interest rate debt first. Then, when that’s paid off, you add what you were paying on it to your next-highest interest rate debt, and continue “down the hill” until everything is paid off. This method can minimize high interest charges.

An alternative approach is the “snowball” approach, where you pay the smallest debt amount first, then go on to the next smallest, and so on, she says. This can provide motivation as you see your successes along the way.

“There are all kinds of ways to get there,” she says. “I recommend people pick one, and then, just do it!”

Other ways out of debt include consolidation loans, where you take a loan to pay everything off and then pay off the loan over time, say three to five years. Gray says if you go this route you might be tempted to start using credit cards again – don’t.

Beyond those approaches, the only ways out of debt are via a consumer proposal, where a trustee negotiates a lower settlement price for your debt, or bankruptcy, which will mean “six years with no or little credit. No one really wants to do this, but for some it may be the only option,” she notes.

A lot of people get lulled into using credit cards because they offer reward points or cash back. “If you are carrying a balance on a credit cards, those points aren’t free – you are paying 21 per cent interest to get points that are maybe worth one per cent of your balance,” she warns.

She concludes by noting that those who are piling up debt on credit cards, and creating a cycle of having no cash flow, need to look at credit “more starkly, to see it for what it is.” They have to break the cycle of credit dependency – that “I deserve to spend, instant gratification mentality.”

In the fourth and final part of this series, we’ll look at setting goals for life.

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