
Cut Credit Costs

Reduce Credit Costs

More than 1 billion credit cards are in use in America today. Used wisely, they can be valuable tools for consumers, but their use represents a substantial portion of Americans' consumer debt problems. Taking control of one's debt with a systematic plan for debt reduction is the key to success.

Getting Out of Debt Is an Investment

Paying off the balance on a credit card is just about the best investment one can ever make. Not having to pay 18% or 22% is the same as earning 18% or 22%, risk free, tax free.

For someone who carries a balance on a card, life is 20% more expensive than it needs to be. If you charge \$1,000 on your credit card and pay just a 2% minimum monthly payment, it could take more than 30 years to pay back that \$1,000 – and you will have paid almost \$5,000 in interest along the way.

Problems of High Debt

Cost. Many consumers carry consumer debt of more than 20% of take-home pay. This is like working a five-day week and getting paid for four, because an entire day's pay is unavailable to use for current expenses.

Long-term debt. Paid at minimum payment levels, high-cost debt becomes long-term debt.

Emotional distress. Feelings of guilt and shame, quarrels and destructive behavior patterns often emerge when families become financially stressed due to debt.

Life on "the edge." Families that live from paycheck to paycheck are at risk of financial disaster when an emergency or sudden loss of income occurs.

Select Appropriate Credit Card

Credit cards are one of the most expensive ways to borrow money; yet, most consumer debt is money borrowed on plastic. Comparing credit card pricing structure (interest rate, fees) can save money. The key to selecting an appropriate card is for consumers to decide how you will repay their debts. Do you:

- **Carry a balance** most of the time? Look for a card with a low interest rate. The larger your balance, the more important a lower interest rate becomes. With a \$10,000 balance, interest would cost \$2,000 on a 20% card and \$1,200 on a 12% card – an \$800-a-year difference.

- **Pay your balance monthly?** Choose a card with no or low annual fee.
- **Charge frequently and pay balance monthly?** Consider an enhancement card. These cards offer rewards based on the dollar amount charged. Typical rewards include cash, airline tickets or free gas. For cardholders who carry a balance, however, enhancement cards can be expensive.

To Reduce Credit Card Costs

1. **Choose lower rate options.** There is no reason to carry a high-rate card when lower-rate options exist. Sources of information about low-rate credit cards include www.cardweb.com and www.bankrate.com.
2. **Shun retail accounts.** Retailers charge some of the highest interest rates (18%-22%), yet they also accept bankcards. Consider closing store accounts.
3. **Pay bills promptly.** Promptly paying credit card bills will reduce their average daily balance and lower interest fees.
4. **Avoid the minimum payment trap.** By making minimum payments on an outstanding balance, you will pay more interest charges. This is especially true if you continue to charge to the account. It would take nine years and six months of 4% minimum payments to repay a \$2,000 balance on an 18% credit card. Beginning in 2010, periodic statements must disclose the period of time and total interest it will take to pay off the card balance if only minimum monthly payments are made.
5. **Avoid nuisance fees.** Costly credit card nuisance fees include over-the-limit charges, late fees, transaction fees and cash-advance fees. These fees may cost as much as \$25-\$49. However the Credit CARD Act of 2009 requires that fees must be reasonable and "proportional to the consumer or violator." Federal regulators are expected to set these fees.
6. **Negotiate lower cost.** In today's highly competitive market, credit card issuers may reduce fees and interest rates, upon request, to attract or maintain the business of customers with good credit histories. Gather information, and think through the issues before contacting the lending agency. Calmly and rationally justify your request for a lower rate.
7. **Shun skip-a-month payment.** Usually offered shortly before or immediately after the holiday season or following a natural disaster, these offers give consumers an option to skip or defer payments for a period. Remember that interest charges still continue when payments are missed. Additional charges also may apply.
8. **Repay high-interest debt with low-interest savings.** Consumers with debt, but with more than adequate emergency savings or investments, are advised to rethink their situations. It is unwise to pay high interest on a credit card balance while earning low rates in a savings account. Repaying a 15% debt is equivalent to earning 15% guaranteed and tax free.
9. **Avoid high interest cash advances.** Credit card cash advances charge interest rates up to 25% or 30%. Few issuers offer grace periods on cash advances. Many credit cards charge a cash advance fee that is based on the amount of the advance.
10. **Be cautious of transferring balances** to cards with low interest rates that are effective for a short period and then jump to much higher rates. Many consumers take advantage of the offer to transfer an existing balance (cash advance) to a lower rate card, but, if the balance is not paid off at the end of the teaser rate, the end result is a much higher cost.

Consider Power Payments

Power payments can reduce debts significantly without changing the total amount being paid monthly to creditors. The first step is to repay one initial debt completely. Next, the money used to repay the initial debt is applied (folded down) to a second debt, in addition to the amount that had previously been paid. All other monthly payments remain the same, as does the total monthly dollar amount allocated to debt repayment. This process continues until all debts are paid.

An online power-pay debt-reduction program is available at www.powerpay.org . This program:

- Computes and summarizes the reduction in pay-off time.
- Calculates savings that can be achieved with a variety of payment schedules.
- Provides a personalized monthly repayment schedule (calendar) for each debt.
- Computes interest savings made possible with:
 - Additional monthly payments.
 - Lump-sum payments.

Debit Counseling

Professional debt-counseling services offer financial counseling to assist households who have or wish to avoid serious debt problems. Consumers who enter a debt-management program agree to commit a specific amount each pay period toward debt repayment. Program participants are required to surrender or destroy their credit cards and incur no further debt while participating in the program. A nominal fee may be required for administrative costs. Select a debt-counseling service associated with the National Foundation for Consumer Credit.

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