Debt Repayment Strategies

If your family has consumer debt, you are not alone. According to Experian's **2020 Consumer Credit Review**, American adults have an average debt of $92,727. Outside of mortgages, the majority of this debt comes from credit cards, vehicle loans, and student loans.

Having debt can feel never-ending, especially if you are getting multiple bills each month. Fortunately, debt can be repaid. By prioritizing debt payments, adjusting your **monthly budget or spending plan**, and choosing a motivational debt repayment method, you could be making progress sooner than you think – and that's important.

The longer that debt goes unpaid – particularly credit card and vehicle loan debt, which tend to have high interest rates – the more interest will accrue, which further increases the amount of money you must repay. Putting just a bit of extra money aside for debt payments each month can make a significant difference to your future finances.

The best way to pay off debt often depends on your "money personality," or what motivates you to stay the course. Consider the following debt repayment strategies:

1. Snowball Method: A strategy in which debt is paid off in order of smallest balance to largest balance, regardless of the interest rates. It involves making minimum payments on all debt and then putting as much extra money toward the smallest debt as possible. Once the smallest debt is paid in full, the amount paid toward that debt can be applied to the next smallest debt, and so on and so forth, until all debts are completely paid off.

- For example, imagine you have three debts: $1,000 in vehicle debt at 8%, $2,500 in credit card debt at 17%, and $5,000 in education debt at 3%. Using the Snowball Method, you would make minimum payments on all three debts, but put all your extra money toward paying off the vehicle debt first, because it is the smallest debt. Once paid off, you would focus on the credit card debt, and finally the education debt.

- This method may be more expensive than the avalanche method described below, but it can help you stay motivated because your number of debts decreases and your list becomes smaller.

2. Avalanche Method: A strategy in which debt is paid off in order of highest interest rate to lowest interest rate, regardless of the amounts. It involves making minimum payments on all debt and putting as much extra money toward the highest-interest debt as possible. Once the highest-interest debt is paid in full, the amount paid toward that debt can be applied to the next-highest-interest debt until all debt is completely paid off.

- Consider the debts mentioned above: $1,000 in vehicle debt at 8%, $2,500 in credit card debt at 17%, and $5,000 in education debt at 3%. Using the Avalanche Method, you would make minimum payments on all three debts, but put all your extra money toward paying off the credit card debt first, because it has the highest interest rate. Once paid off, you would switch to the vehicle debt, and finally the education debt.
- This method will minimize the amount of interest you will pay over time, but without the quick wins of paying off small debts, it may be harder to stay motivated.

3. Snowflake Method: A strategy that adds on to either the Snowball or Avalanche Method to help pay off debt faster. It involves putting found money, or money that is not accounted for in a budget (like a birthday gift, rebate check, tax refund, or income from a yard sale), toward debt payments to speed up your progress.

4. Debt Consolidation Method: A strategy that allows you to combine multiple debts into one new debt at a lower overall interest rate, thereby making your payments more manageable. This method is often used when the debts involved are credit card debts spread over a variety of cards with relatively high interest rates.

However, use caution when considering debt consolidation. You may see a drop in your credit score as you are effectively closing accounts and increasing the balance of one debt. Furthermore, while you may be attracted to low-interest-rate introductory offers, note that the rate often increases considerably after a period of time. If the balance is not paid off before the interest rate adjusts, you could end up paying more interest in the long run. Personal loan and debt consolidation companies also typically charge fees, so not all of your payment is going to reduce your debt. Nonprofit debt consolidation companies may offer better options. Finally, it is important to realize that if you combine debts such as student loans with credit cards you can lose unique protections that come with those loans.

That said, the two most common methods of debt consolidation are:

1. Signing up for a balance transfer credit card, which allows you to transfer your outstanding balances to a single card with a single payment. These cards often have 0% interest for a period of time and may be a wise move if you have the ability to pay off the balance transferred within 12–18 months. They may require that you have a good credit score to qualify.
2. Consolidating your debt by taking out a personal or consolidation loan, which allows you to use the loan amount to pay off all of the credit card balances, leaving you with one monthly bill for the repayment of the loan. This may help you repay debt in the long run by lowering your interest rate and simplifying your payments.

The method of debt repayment that is right for you depends on the type of debt that you have and what motivates you. If you want to see progress fast, the debt snowball may be a better option than the debt avalanche. If high interest payments bother you, you may be more motivated by the debt avalanche. Consolidation can provide the convenience of fewer payments, while the snowflake method can give you a motivational boost when you have an unexpected influx of money. No matter which method(s) you choose, maintaining a strict budget and cutting your expenses can help you stay on track to meet your goals.

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