

# THE DEBT TRAP

*Do you know that South Africa is a nation of people in serious debt?*

*Debt is the number one financial problem for high and low earners alike. The more we borrow, the more interest we pay and the less disposable income we have. Debt brings worry, stress, marital problems and a sense of hopelessness about the future. Debt can also enslave us — especially if we do not honestly face the problem and make a plan to get out of it and stay out of it.*



## Getting out of debt — where do you start?

### 1. Face the problem

Make a list of all your creditors and write down how much you owe each one.

### 2. Draw up a budget

Paying off your creditors has to be your first priority. Put fixed expenses (electricity, water, school fees and rent or bond repayments) and a limited grocery expense at the top of your list. From what you have left, work out how much you can afford to pay each creditor each month.

### 3. Discuss the situation with your family

One of the biggest obstacles to overcoming debt is lack of co-operation among family members. This is not something you need to discuss with the children. But if you have adult family members depending on your income, discuss the situation with them. If your family is to get out of debt, all the members must co-operate. All must agree on the budget you have drawn up and stick to it. It takes discipline, but it can be done.

## If your problem is serious

Unmanaged debt can land you in serious trouble. If you are afraid to open letters from the bank, and regularly throw away bills, you are running away from a problem. The problem will eventually find you. People who do not pay their debts end up being **blacklisted**. This means your name is forwarded to the Credit Bureau, which keeps a list of all debt defaulters. (More about Credit Bureaux on page 15.) Being blacklisted seriously restricts your financial freedom. On page 33 are details about what you can do if this happens.

If you are in serious financial trouble, and you own a home, your first priority is always to protect your home. Face up to the problem and contact your bank. Explain the seriousness of your situation. Ask them to work out the lowest possible repayment plan for your home loan that is acceptable to them. Then stick to the agreement. Don't run away from the problem!

# MANAGING DEBT

*Most of us have discovered that to live entirely debt-free is almost impossible in our modern world. Overdraft facilities and retail accounts can be extremely useful, making life easier when cash is short.*

*The danger is in seeing credit as a free-for-all. Credit gives licence to a most basic human urge — the urge to buy and own things.*

**T**his urge, if unchecked, can grow out of all proportion. Buying things that we do not need can become a way of life. This is fine if we have unlimited money. But if money is limited, we have to prioritise. Many people never learn to prioritise, and as a result find themselves in quite a mess.

**P**rioritising means paying for essentials first. Bond repayments, rent, car repayments, school fees and food are essentials. If these are not paid, the consequences are serious. These are often neglected because uncontrolled spending on credit has swallowed half our salary. If you are spending so much on paying off clothing and appliance accounts that you cannot afford essentials and have to resort to your credit card to pay for groceries, you are getting into deeper trouble every month.

**H**ow do you manage debt well? First, by reducing the amount of debt that you are in. An acceptable level of debt is if you can pay the full instalment every month, without defaulting on other obligations. Remember, always pay off the debt with the highest interest rate first!

If you pay less than the full monthly instalment, you incur interest. This makes the following month's instalment higher — making it even less likely that you can afford the full instalment. In this way, a vicious cycle begins.



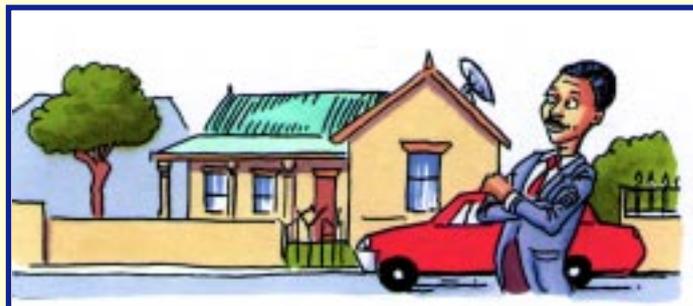
**D**o not be tempted by the promises of debt mediators. They may fail to distribute your money to creditors, causing you further financial difficulties. And remember, it is illegal for them to charge you an upfront fee.

# WAYS TO REDUCE YOUR DEBT

*As debt eats further and further into our limited resources, we need a strategy to reduce debt.*

## 1. Know your debt

The first line of defence is knowledge. Know each debt, and its terms of repayment. Most importantly, know the interest you are paying each month on each debt. Then you will know which debts are a priority to pay off as soon as possible, and which you can afford to carry a little longer.



*For example: Gerald owes R5 000 on his credit card and R50 000 on his home loan. The bank charges 24% interest per year on his credit card, and 15% per year on his home loan.*

*This works out to 2% interest per month on the credit card (R100 a month) versus just over 1% interest per month on his home loan (R625 a month). Which debt is the priority to pay off first? The one with the higher monthly amount may seem to be more important, but this is misleading. The answer is the one charging the higher interest! Gerald would be wise to pay off more than the minimum monthly payment on his credit account to clear this debt as soon as possible.*

## 2. Consolidate your debt

One way to reduce one's monthly debt repayments is to consolidate one's debts. You borrow enough from your bank to pay off the many smaller debts at once. You then have only one creditor – the bank (see page 13).

Do your homework carefully. Check that the overall interest you will be paying is less than the total on your individual accounts! You will have to convince the bank that you can stick to your agreement – in other words, that you are serious about your plan.

### 3. Rationalise your insurance

If you feel you are paying for too much insurance, you can possibly reduce the total amount of your premiums. Get advice. If you cancel (lapse or surrender) a risk policy, you lose your cover. But if it is an investment policy, you could lose what you have already paid into it. Find out the best way to get your life or endowment policy to fully paid-up status, or whether you can reduce the premiums. Don't lapse or surrender a policy without checking what the implications are. Ask your insurance intermediary for advice, but think carefully if he suggests replacing one policy with another. If you want to confirm that the advice is in your own best interest, you can phone the insurance company's Customer Helpline.



### 4. Pay off your home loan

#### Plan A

*If you pay just 10% more than your monthly instalment, you will pay off your home loan in a much shorter time.*

#### Plan B

*Take any windfall and pay it on your home loan. Use your annual bonus or sell the second family car! An extra once-off payment of R5 000, for instance, will eventually save you thousands more over the term of your bond, because you will not have to pay the compound interest on it!*

#### Plan C

*Unless you have a fixed interest rate, your instalments will change with the current rate of interest. When it drops, keep up the higher payment. You will be surprised how much interest it will save you in the long run!*

### 5. Spend less

The quickest and most sustainable way to get out of debt is to practise self-control. We live in a world that promotes spending. We are subjected to an almost constant bombardment of TV, radio and magazine advertisements urging us to spend, spend, spend.

We need to become more aware of how we are tempted by advertisers to want things that we do not really need. We need to remember other expenses that may become a priority in the near future, e.g school fees, bond repayments, a car. We simply cannot buy everything our hearts desire. Many people have expensive cars, grand homes and designer clothes. We tend to look at them and want what they have. But remember, real happiness and success come with managing what we have – not trying to have things we cannot afford.