ADPACHIEVE

Newsletter

Winter 2023-2024

Strategies to manage your debt

It's easy to understand why we carry debt. I mean the preferred payment method for many restaurants and stores is debit or credit cards and not cash. We are almost programmed to use our plastic.

In fact, according to NerdWallet, as of September 2023, the average American household held $167,947 in debt. The total credit card debt was $20,221 and student loan debt averaged $55,347

While it's important to make sure you are paying your credit cards on time, making minimum payments will cost you in the long run because of the interest paid.

Let's look at how that works based the credit card details below:

CREDIT CARD #1
Balance: $1,500
Annual interest rate: 11%
Minimum monthly payment: $55
Extra payment: $100

CREDIT CARD #2
Balance: $5,000
Annual interest rate: 26%
Minimum monthly payment: $130
Extra payment: $0

You decide to make an extra $100 payment to credit card #1 because the interest rate is low and the minimum monthly payment is just $55. However, you're paying 25% interest on credit card #2 and only paying the monthly minimum payment.

Based on this it will take you 84 months to pay off credit card #2. **Over the course of that 84 months, you would have paid $5,866 in interest to credit card #2, making the total paid $10,866!**

If you took the extra $100 payment you are making to credit card #1 and increase your credit card #2 payment to $230, your payoff time is just 30 months. The total interest paid would be $1,833 and that makes your total paid to $6,833.

Still want to make that minimum payment? Most credit card statements have projections on them, it would be beneficial to look at your statements to see how long it will take you to pay off a balance making minimum payments. You might be surprised at what you find.

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Methods for paying off debt:

There are two methods for paying off debt, the Snowball method and the Avalanche method.

The Snowball method focuses on balances, prioritizing paying the lowest balance debt first while paying the minimum amount on other debts.

Using this method, you would continue to pay $130 on credit card #2, while focusing on paying off credit card #1. You would add the extra $100 to this minimum monthly payment and continue paying the $155 until the credit card is paid off.

Once it's paid off, you would focus on paying off credit card #2. You would take the $155 you were paying on credit card #1 and combine that with the amount for credit card #2 and pay $285 a month until this credit card it paid off too.

This method is ideal for those who will stay motivated by paying down smaller debts sooner, you'll see results sooner with eliminating debt. With this method you're not looking at the interest rates, only balances. The downside of this method is that you may not reduce the amount of interest you're paying.

The Avalanche method focuses on interest rates, prioritizing paying the highest interest rate debt first while paying the minimum payments on other debts.

Using this method, you would take the highest interest rate, which is credit card #2 with an interest rate of 26%. An extra $100 is sent for a total payment of $230. Once that balance is paid off, you would move to the next highest interest rate which is credit card #1. Like the snowball method we just talked about, once credit card #2 is paid off, you would take the $230 you were paying and put it towards credit card #1 so you'd be paying $285 total.

The advantage of this method is that it can reduce the amount of interest you pay by focusing on the highest interest rates first, but it may take a while before you start to see noticeable changes in your debt so it requires more discipline to stay on track.

In either method, if you can automate your higher payments, even better! Once that balance is paid off, you would move to the next credit card or loan.

Both strategies work effectively, depending on your financial situation one may work better than the other. If you're someone who likes to see "quick wins" then the Snowball effect may be for you. If you're more focused on saving as much as you can, then the Avalanche method works for you.

Your money situation can change — you get a raise; you won money from a scratch-off ticket or at BINGO; your car needs to be repaired or one of your children needs braces. You could even take action to increase your contribution rate in your retirement plan. All of these are ways that can change your financial circumstances. The key is to remember some of your circumstances are only temporary. When you pay down your debt, it will eventually get paid off and your money situation will change again.

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