

Using power payments to pay off debt

A key to good financial health is gaining control of your debt. Setting this goal is just the first step. Now it's time to get to work. Use "power payments" to pay off debt and save money in the process!

Power payments work like this: As soon as you pay off one debt, you roll that monthly amount—the **power payment**—over to another debt. The process continues until all debts are repaid. The total amount paid for debt repayment stays the same each month. You don't have to come up with extra money to make this technique work.

But to be successful, you must make a commitment not to take on any new debts—or make any new charges to existing accounts—until all debts are repaid.

PowerPay© is a computer program that calculates what your repayment and interest costs will be if you continue making payments at the current level. It then calculates possible savings by using power payments.

To see how this works, take a look at the PowerPay Analysis Summary printout shown in Table 1. In this example, a consumer is making monthly payments on three debts: \$50 on a department store revolving charge account, \$150 for a car loan, and \$19 minimum payment on a credit card balance. Each debt has a different interest rate, ranging from the 22 percent annual percentage

rate (APR) for the department store account to the 6.99 percent 6-month introductory rate on the credit card. The total debt is \$6,950.

The middle section of the Analysis Summary compares the amount of time and cost of paying off the debts—with and without power payments:

■ **Without power payments,** it will take seven years (84 months) to pay off the \$6,950 balance, and will cost \$1,711 in interest charges.

■ **With power payments,** it will take about three years (38 months) to pay off this balance, and will cost \$1,202 in interest charges—**saving \$508 and reducing the repayment time by almost four years!**

The PowerPay© Debt Reduction Calendar (Table 2) illustrates how power payments are used. Notice that in January 2008, the department store balance is paid off. The \$50 monthly debt payment is now applied to the credit card balance, because it has the highest interest rate—17.89 percent after the introductory rate ends. Then, after the credit card debt is repaid, the total monthly debt payment is applied to the car loan.

Note: Payments above the minimum on revolving debt will reduce the principal balance, but that isn't always the case with installment loans. Because the car loan is an installment loan with fixed payments, be sure your lender will apply extra payments to the principal of the loan.

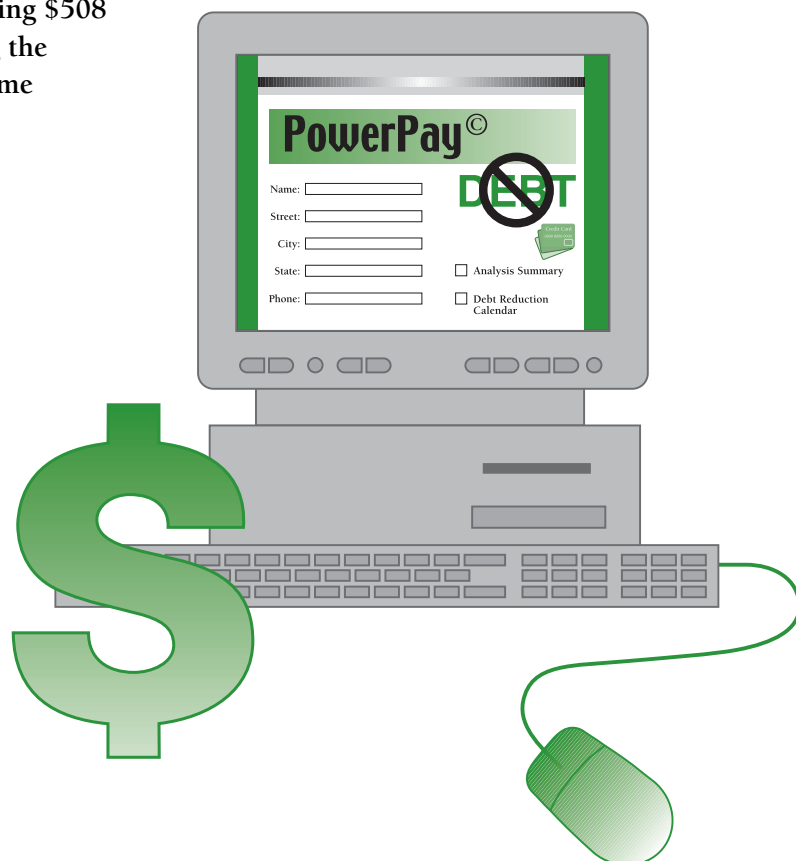


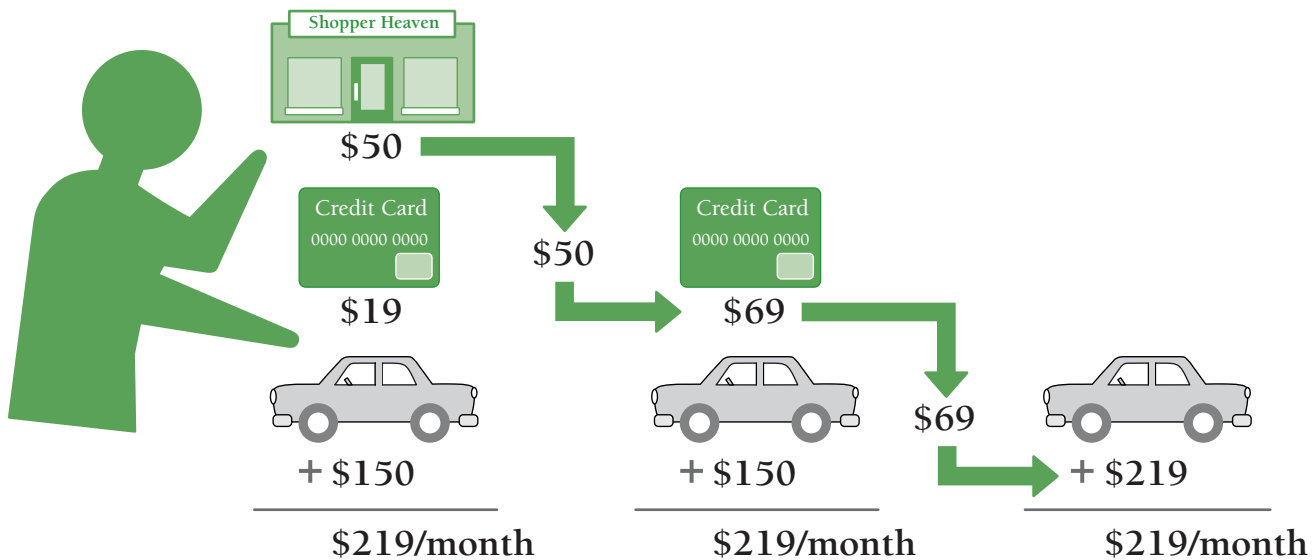
Table 1. Analysis Summary

ANALYSIS SUMMARY				
NAME: Joanna Doe			DATE: January 2007	
Creditor Name	Current Balance	Monthly Payment	Annual % Rate	Approximate Time Without Power Payments
1. Department Store	500.00	50.00	22.000%	1 year 0 months
2. Car loan	5,500.00	150.00	9.500%	3 years 8 months
3. Credit Card	950.00	19.00	* 6.990%	7 years 0 months

Without Power Payments			With Power Payments (Paying debt with highest interest rate first)			
Creditor name	Number of Payments	Total Paid	Interest Paid	Number of Payments	Total Paid	Interest Paid
1. Department Store	12	557.44	57.44	12	557.44	57.44
2. Car loan	44	6,522.55	1,022.55	38	6,454.91	954.91
3. Credit Card	84	1,581.45	631.45	25	1,140.60	190.60
Total monthly payment varies			Total monthly payment 219.00			
Time to repay 7 years			Time to repay 3 yrs 2 mo			
Loan amount repaid \$6,950.00			Load amount repaid \$6,950.00			
Interest paid \$1,711.44			Interest paid \$1,202.95			
Total amount paid \$8,661.44			Total amount paid \$8,152.95			

Summary of Benefits from Making Power Payments
 Time required to pay off all debt reduced by 3 years 10 Months
 Amount of money saved \$508.49

PowerPay analysis provided by: Iowa State University Extension Service
 *Credit Card Multiple Interest Rates:
 Introductory rate (first 6 months) 6.990%
 Rate (after 6 months) 17.890%





Adding lump sum or increasing monthly payments

In addition to power payments, you can get out of debt faster by increasing the amount of your monthly payments.

Sometimes you may be able to make an additional one-time lump sum payment on your debts. For example, you could use an income tax refund or overtime paycheck to increase the amount paid to creditors for a month. Table 3 shows how an additional \$300 lump sum payment made in April 2007 increases the amount of savings and shortens the time it would take to repay the three debts by four years.

Increasing the amount of your payments each month will also reduce the length of time it takes to repay your debts and reduce the interest charges. Notice in Table 3 that by adding \$25 a month to the payment amount, the debts are paid off in less than 3 years (2 years, 9 months)—**saving nearly \$700 in interest costs.**

Table 2. PowerPay® Debt Reduction Calendar

POWERPAY DEBT REDUCTION CALENDAR			
Debt with Highest Interest Rate Paid First			

NAME: Joanna Doe		11Jan07	
Monthly Total of All Payments:		219.00	

Month	Department Store	Credit card	Car loan
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Feb-07	50.00	19.00	150.00
Mar-07	50.00	19.00	150.00
Apr-07	50.00	19.00	150.00
May-07	50.00	19.00	150.00
Jun-07	50.00	19.00	150.00
Jul-07	50.00	19.00	150.00
Aug-07	50.00	19.00	150.00
Sep-07	50.00	19.00	150.00
Oct-07	50.00	19.00	150.00
Nov-07	50.00	19.00	150.00
Dec-07	50.00	19.00	150.00
Jan-08	7.44	61.56	150.00
Feb-08		69.00	150.00
Mar-08		69.00	150.00
Apr-08		69.00	150.00
May-08		69.00	150.00
Jun-08		69.00	150.00
Jul-08		69.00	150.00
Aug-08		69.00	150.00
Sep-08		69.00	150.00
Oct-08		69.00	150.00
Nov-08		69.00	150.00
Dec-08		69.00	150.00
Jan-09		69.00	150.00
Feb-09		42.04	176.96
Mar-09			219.00
Apr-09			219.00
May-09			219.00
Jun-09			219.00
Jul-09			219.00
Aug-09			219.00
Sep-09			219.00
Oct-09			219.00
Nov-09			219.00
Dec-09			219.00
Jan-10			219.00
Feb-10			219.00
Mar-10			49.95

Table 3. Adding lump sum or increasing monthly payments

	Total Amount Paid	Interest Paid	Amount Saved	Time to Repay
Without power payments	\$8,661.44	\$1,711.44	none	7 yrs
With power payments	8,152.95	1,202.95	\$508.49	3 yrs 2 mo
Power payments plus \$300 lump sum	7,998.62	1,048.62	662.82	3 yrs
Power payments plus additional \$25 per month	7,968.77	1,018.77	692.67	2 yrs 9 mo

Finding the money to increase your payments

Where can you find the money to increase your monthly payments?

Review your spending habits to find some small changes you can make that could add up to big savings. For example, cutting back on eating out, long distance calls, or lottery tickets could free up an additional \$20 to \$30 a month to repay debts.

And as the examples in the tables show, a small increase in your monthly payments can make a big difference in getting out of debt.

Making power payments work for you

Power payments can get you out of debt faster and save you money.

■ First, make a commitment to stop borrowing or charging until all your debts are repaid.

■ Determine how much money you have to repay debts. Instead of making only minimum payments on credit card accounts, try to make the largest monthly payment you can afford.

■ Next, use power payments to repay your debts faster and reduce the

interest costs. As soon as one debt is totally repaid, apply the monthly payment from that debt to pay off another creditor.

■ Continue to combine the money from paid debts until all debts are paid.

■ Consider adding lump sums to your power payments or increasing your monthly payment amount when you have extra money.

Learning how to use power payments can put you on the path to being debt-free.

For more information or to request a personalized PowerPay Analysis, contact your county Extension office and ask for PM-1873b or print the form from the ISU Extension Web site at www.extension.iastate.edu/finances/personal/creditdebt.

Or visit www.powerpay.org and follow the instructions to complete an analysis online.

PowerPay© 5.0 Debt Reduction Software was developed by Utah State University Cooperative Extension.

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... and justice for all

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