Your Monthly Money

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A product of Consolidated Credit® When debt is the problem, we are the solution.

Don’t Make These 6 Mistakes When Paying off Debt

If you’re serious about getting rid of debt, don’t let these debt payoff missteps trip you up

After years of making little progress paying off revolving credit, student loan, or medical debt, one day you had an epiphany: It’s time to get out from under the thumb of creditors and create more freedom in your life by paying off those debts once and for all.

Now that you have that debt payoff goal in sight, however, it’s still easy to get off track – or barely move at all – by making common mistakes that people make all the time when they’re trying to pay off debt.

1. Waiting to build emergency savings

Once you get serious about paying off debt, it’s easy to become so gung ho about your goal that you throw every extra dollar at bills or loans. Those focused payments are great, but first, put some money in an emergency fund, even if it’s only $500 to $1,000.

If you don’t have emergency savings and your car needs repair or your air conditioner grinds to a halt, you may have to charge those costs to your credit card, incurring even more debt. Better to have emergency funds on hand to take care of unexpected bills.

2. Not having a debt payoff plan

Setting out to pay off debt without a plan is like driving to another city with no map to guide you. You’ll probably get lost and end up backtracking or taking detours that significantly delay arrival.

Instead, create a realistic timeline and plan for how and when you want to reach a zero balance. If you’re married, make sure you and your spouse each have a say in how to reach financial goals.

3. Making only minimum payments

If all you’re paying each month on your credit card is the minimum monthly payment, you won’t make much headway with paying down debt. You’ll also pay interest on the balance every month.

Your credit card statement contains a "minimum payment warning," detailing how many months it will take to pay off the balance when making only minimum payments and the total cost, including interest. Always pay more than the minimum payment due.

4. Closing the credit card once the balance is paid

Once you pay off the credit card debt, don't cancel the card to eliminate the temptation of going into credit card debt again. By keeping the card open and the balance at zero, you could improve your credit utilization rate – your ratio of revolving debt to available credit – which comprises around 30% of your credit score.

Then seek nonprofit credit counseling to help you create a budget and learn willpower so you don't run up the credit card again.

5. Not exploring balance transfer options

If you have good-to-excellent credit and a large balance on a high-interest credit card, consider applying for a credit card with a 0% APR on balance transfers for anywhere from 12 to 21 months to save money on interest.

Let's say you transfer a $4,000 balance on a credit card with a 15.99% APR to a new credit card that has a 0% APR for 18 months. If you pay $225 a month, you won't pay any interest, paying the debt off in 18 months and saving nearly $600 in interest.

Most offers come with a 3% to 5% fee on the balance transferred, so make sure you can still come out ahead after the fee. For instance, in the example above, a 3% balance transfer fee would be $120, so even after the fee, you would still save $480 overall.

6. Borrowing from your 401(k)

Taking a loan against your 401(k) to pay off debt should be an option of last resort. For one thing, you'll miss out on growth if the market improves. You may not be able to pay off all your debt with a loan or fall even more deeply into debt later and be unable to repay the loan.

You could also be in trouble if you lose or quit your job, since retirement plans often require a quick payback once you're no longer employed with the company. In most cases, if you're under the age of 59½ and can't pay the loan back, you'll also have to pay taxes and an additional early distribution penalty if you can't repay the loan on time.