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How to reduce debt and improve your finances

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It's normal to accumulate some debt during a difficult time like COVID-19. Here's how you can come out of it and get your finances back on track.

Have you been paying less towards your bills and loans due to the COVID-19 pandemic? Or maybe you've gathered more debt because of a COVID-19-related recent job loss? That's all okay.

"It's okay to pause on your savings during an emergency or if you're having a difficult situation," says Joel Oretan, Regional Director of Estate and Financial Planning Services at Sun Life.

However, as social-distancing measures ease down, Oretan emphasizes the importance of getting your finances back on track. To do this, you need to have clear guidelines on how to manage your debt. This way, you can improve your financial outlook going forward.

To start, let's look at the different types of debt.

2 basic types of debt

Oretan finds that there are usually two types of debt: **closed-end debt** and **open-end debt**.

Closed-end debts includes debts that you need for a certain reason and for a certain period of time. This could be a mortgage, a car loan, student loan or a personal loan.

Open-end debts are sometimes called revolving debts. They're debts you continue to borrow off of until you hit a maximum limit. Examples of revolving debts include lines of credit, credit cards and equity loans.

You may be using these debts to cover essential needs, such as:

- supporting your finances due to a COVID-19-related job loss,
- managing your daily expenses,
- paying for housing,
- saving for retirement (e.g. RRSP loans),
- caring for your children, or
- caring for your aging parents.

"There are a variety of different needs and uses for debts when we look at it," says Oretan. "Debt [can be] a good thing. But it's important to make sure you manage your debt and use it appropriately."

What happens if you have too much debt?

Debt isn't necessarily a bad thing, unless you have too much of it. Oretan stresses four particular risks that come with borrowing too much:

1. It's habit-forming to the point where you rely on them too much.
2. It takes away money from other important needs.
3. It can damage your credit rating if you can't pay the bills.
4. It can lead to high-interest payments that are harder to make.

Basically, having too much debt can leave you with bigger bills and a lower credit score. Plus, you may miss out on the chance to make new purchases that are important to you because you already have so much to pay back.

What can you do to reduce your debt?

1. Make a budget and get budget counseling

If you're trying to get your finances on track, Oretan recommends making a budget or reviewing your current budget.

"It's a critical step to reducing your debt," says Oretan. "If you don't know where your money's going, how can you make sure it's going to the right place?"

Looking at a budget provides a great opportunity for you to:

- review what you're spending your money on and see if you still need those expenses,
- separate your needs and wants, and
- set your spending priorities.

For example, while reviewing your budget, you may find that you have some unused subscriptions you can cancel. You can then place some or all of that money into something that has more priority for you. For instance, you could use that money to help make payments you had to delay these past few months due to COVID-19.

Need help making or keeping up with your budget? Oretan suggests talking to an advisor for budget counseling. An advisor can help you build a plan that meets your financial needs and goals.

2. Consolidate your debts

"If you have multiple debts, try to consolidate them into one easy payment," Oretan suggests.

Let's say you have debts on three different credit cards. Each one has a 20% interest rate. You can call your bank and ask to consolidate all these debts into one account at a lower interest rate. This way, you'll only have to make one monthly payment at a much lower interest rate. This can help you pay off your debt faster.

3. Talk to your bank or creditors

Oretan also recommends shopping around for the lowest interest rate. So call up your bank or creditors and ask what options they have available.

Let them know that you're trying to reduce your debts and ask them:

- what they're doing to help their customers transition into a "normal" routine after COVID-19 and
- what resources they have available to help you improve your finances.

4. Get professional help from an advisor

It can be challenging to stay on track of your finances, especially if you're recovering from a difficult situation or setback. But you don't have to do it alone, says Oretan.

"An advisor can work with you through your financial journey," he adds. An advisor can address any financial concerns or questions you may have. They can also help you:

- find ways to reduce your debt and save more money,
- review your current financial situation,
- make well-informed financial decisions,
- make a plan that meets your short- and long-term goals,
- revise your plan as your needs change,
- feel assured in times of uncertainty, and
- avoid making emotionally-driven decisions about your finances.

Most advisors now offer to meet with Clients virtually by video chat.