Let's Talk Finances

Things to Consider Before Consolidating Debt

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Consolidating debt is a common debt management strategy. In short, it involves combining multiple debts into a single loan, making your overall debt easier to handle. It may even reduce the total amount you will repay via lower interest rates. However, consolidation is not always as simple as it seems. The following are three important tips for anyone considering debt consolidation.

Change your habits

Consolidation is not a silver bullet for debt problems. For the strategy to work, you need to change the habits that led you to consider debt management in the first place. In most cases, the best way to do that is with a realistic budget.

Your budget should, at the basic level, account for debt payments, recurring expenses such as groceries and utilities, retirement savings contributions and an emergency fund. You should also attempt to anticipate infrequent or seasonal expenses like car registration fees, insurance, and holiday purchases.

Finally, it's important to leave some room in your budget for fun. If all you do is save money and never buy anything that makes you happy, you're more likely to end up splurging and going over budget.

Check your credit reports

Before you settle on a debt consolidation plan, get a credit report. Normally, you can check your credit report with all three major credit bureaus (Equifax, Experian and TransUnion) once a year for free. However, through April 2021, all three agencies are offering free reports weekly when you request them via AnnualCreditReport.com. This can be helpful not only to be more informed when it's time to decide on a plan, but also to look for any errors. An error on any of your credit reports could prevent you from qualifying for the debt consolidation help you need. Over the course of years, such errors can potentially cost you thousands of dollars in higher interest rates. If you find an error in your credit report, dispute it. Clearing errors may not only help you qualify for debt consolidation, but also give you access to lower interest rates.

Learn your options

There are multiple ways to consolidate debt. If you have good credit, you may wish to consider transferring high-interest credit card balances to a single card with a lower APR. Another option is to take out a personal debt consolidation loan, giving you a concrete plan (usually three to five years) for paying off your old debt. Both of these types of loans are unsecured, meaning they require no collateral. Instead, your creditworthiness is taken as an indication that you will be able to repay.

If your credit is not good, you may instead need to get a secured loan. This requires you to put up collateral, such as a car or a home. These loans tend to give you more borrowing power and lower interest rates, but also put your property at risk if you fail to make your payments. Under these conditions, making a budget and borrowing only as much as you need are of paramount importance.

Ultimately, the best way to consolidate debt - and whether debt consolidation will work for you at all - depends on your unique financial situation. To explore the best options for you, consult an expert at your local financial institution.