

# Debt consolidation

## Definition of Debt Consolidation:

- A financial strategy that involves merging multiple debts into one consolidated loan.
- Primary Aim: To simplify the repayment process and possibly obtain a more favourable interest rate.

## Key Reasons to Consider Debt Consolidation:

1. **Organisational Challenges:** Difficulty in managing multiple debt repayments with varying due dates.
2. **Credit Pitfalls:** Situations where a significant portion of income is directed towards interest payments, leaving little to tackle the principal debt.
3. **Burdensome High-Interest Debts:** Encumbrances such as credit cards, store credits, or cash advances that come with steep interest rates.

## Popular Consolidation Strategies:

1. **Refinancing:** Transferring debts to a new credit source with a more favourable interest rate or fewer associated fees.
2. **Extending Loan Duration:** For instance, resetting a mortgage to its original 30-year term to reduce monthly payments.
3. **Modifying Repayment Terms:** Switching to interest-only payments or other flexible terms on an existing loan.
4. **Hybrid Approach:** A tailored combination of the above strategies to fit individual needs.

## Goals & Important Considerations:

- **Debt Reduction vs. Management:** While consolidation simplifies repayments, it doesn't inherently reduce the total debt. It's essential to differentiate between the two.
- **Behavioural Change:** For effective debt reduction, consolidation should be paired with a change in spending habits. Tools like the ASIC's MoneySmart budgeting are great.

## Key Benefits of Debt Consolidation:

1. **Simplified Management:** One consolidated loan is easier to track and manage.
2. **Potential Savings:** There's a possibility to save on interest and fees, especially from high-rate debts.
3. **Cash Flow Improvement:** By securing a lower interest rate, monthly interest payments can be reduced.
4. **Payment Flexibility:** Options to reduce monthly payments by adjusting terms.
5. **Relief Options:** Some lenders specialise in assisting individuals with past credit issues, offering a fresh start.

## Critical Factors to Keep in Mind:

1. **Long-Term Financial Implications:** Extending the loan term can lead to higher interest costs over the loan's duration.
2. **Avoiding Additional Debt:** After consolidating, it's crucial to close cleared credit accounts to prevent accruing new debt.
3. **Interest Rate Fluctuations:** Consolidating all debts, especially into a mortgage, can be risky if interest rates increase.
4. **Equity & Refinancing:** Using mortgage equity for consolidation can have implications on property value and might lead to additional costs like Lenders Mortgages Insurance (LMI).