creditaction
Better thinking about money

Consolidation Loans

Debt consolidation occurs where a consumer takes out a loan or other credit agreement in order to pay off two or more existing debts. A variety of credit products can be used including:

- an unsecured loan
- an advance from an existing mortgage provider secured against property but leaving the original mortgage intact
- a second charge mortgage (a loan secured on property, from a lender other than the existing mortgage provider, that leaves the first charge mortgage in place)
- a remortgage
- the transfer of balances to a credit card (including the use of credit card cheques to pay off non-credit card debts).

Some of these products turn unsecured debts (debts not secured on your home e.g. credit card debts, store card, some personal bank loans, overdrafts) into debts secured against your home in return for lower monthly payments. ***The danger is that any lapse in your ability to pay could mean losing the roof over your head.***

Some of the advantages are:

- Consolidating your debts focuses your attention on paying down one single debt rather than trying to keep up with several, smaller ones. A single payment is made each month v multiple payments.
- Typically the interest charged on the one loan should be lower than you would have paid on your debts beforehand so it can reduce the monthly interest payments also reducing your monthly outgoings.
- It can be daunting to see how much all your loans amount to when grouped together but ignoring the problem just makes it worse.
- Credit rating is preserved if done in time.
- Helps to balance the books.
- Prevents further action from creditors if debts paid off.

Some of the disadvantages are:

- Many people assume that once they have bundled their existing debts into one little package they have somehow drawn a line under them and cleared them off. Nothing could be further from the truth. It is well known that a high proportion of people who take out loans to consolidate their debts go on to run up further debts before they've cleared the first lot. This

can lead to a false sense of security and high feel good factor which leads to further spending.
- Although it's tempting to go off and start spending on that newly cleared credit card again that is the worst thing you could do in such a situation. This merely adds to your problems. Very few people get rid of credit cards once they have paid off the balance using a consolidation loan. They should be cut up and sent back!
- It's estimated that the majority of people who take out a consolidation loan actually end up further in debt. Many end up taking out a second consolidation loan in 12 months. The reason for this is they carry on spending more than their budget. The second consolidation loan is then the sum of the first consolidation loan plus new debts. Many people who ring our helpline are on their 3rd and 4th consolidation loan.
- The loan should not be secured on your house. In the UK there are unsecured debts and secured debts. If you default on secured debts then your home is at risk if you do not keep up repayments.
- Many borrowers, particularly those in financial distress, are unaware of other alternatives which are open to them, such as negotiating with creditors themselves or getting help from free debt counselling services
- The interest rate may seem lower but spread over a longer period of time you may well end up paying more. If the consolidation loan is secured on your home it can mean stretching a five year personal loan to a home loan over up to 25 years. You need to review the total interest paid over the whole term of the new loan.
- If the loan is secured on your home then you may well be offered expensive payment protection insurance (PPI) as well as the consolidation loan. These may sometimes be sold inappropriately to borrowers who are unlikely to be able to claim on it.
- Sometimes substantial set up charges are added to the loan.
- Sometimes the loan cannot be paid off early without significant penalties.
- Debt Consolidation companies will often charge a higher interest rate than a mainstream mortgage lender. Both types of consolidation loan, however, would be secured on your home.
- If the person has a poor credit rating then the interest may be higher. This is especially the case for subsequent consolidation loans.

No one should do anything until they have completed a budget with all their monthly income & outgoings. When this has been done you will be able to see what money is left over at the end of the month to service your debts. If it is not enough to meet the consolidation loan then a consolidation loan shouldn't be taken out.

A budget pack and self help guide to getting out of debt can be downloaded from our web site.

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