Debt consolidation

Generally the home provides the opportunity to secure the most cost effective debt available in the form of a home loan. As the home is used as recourse against the loan, it provides the lender with additional security allowing them to lend money to you with greater certainty and at a lower interest rate. Credit cards and other store loans are provided without security and therefore charge much higher rates of interest as in the event of default they are unable to immediately gain access to your assets to seek repayment of their loan.

In the majority of instances you will be financially better off utilising your home loan given the potential interest savings.

It is important to remember though that good budgeting, spending within your means and controlling your discretionary spending are the key to getting ahead financially rather than continually spending borrowed money. A good savings and investment plan and debt reduction strategy are important tools in securing your financial independence.

How it works

To ensure that you are minimising your interest payable on a soon to expire interest free loan or credit card that is unlikely to be paid off in the foreseeable future you may like to consider debt consolidation as part of your debt reduction strategy. This involves taking multiple debts and consolidating them into one loan with a much lower average interest rate. A home loan usually has the lowest interest rate.

Example

Debts before consolidation:

Debt	Balance ($)	Interest rate	Monthly payment ($)	Term (years)
Mortgage	250,000	5.5%	1,535.22	25
Car loan	17,300	9.5%	363.33	5
Credit card 1	3,000	17.5%	143.33	2
Credit card 2	6,500	19.5%	329.24	2
Store card	1,500	20.0%	76.34	2
Total	278,300		2447.46	

Consolidating your debts into your existing home loan at an interest rate of 5.5% could achieve a number of objectives:

Reducing your interest paid - Ideally you should maintain your current monthly payments and aim to reduce your debt more quickly to take advantage of a lower average interest rate enabling you to pay off your debt in 13.4 years and save $101,403 in interest.

Reducing your monthly repayments - In this example, in the event that you are unable to meet your monthly repayments, consolidating your debt will allow you to reduce your monthly repayments to $1,709.01 and allow you to regain control of your finances. This should only be undertaken for a short period of time as you will pay additional interest of $17,162.39 as a result of a number of the loans being repaid over a longer term. Sometimes when you refinance it gives you a false sense of security with the additional cashflow available to spend each month. Don't be fooled or you may end up in a different financial position.

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