Your ultimate guide to debt consolidation

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What is debt consolidation?

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Before you decide whether debt consolidation is the right option for you, let's cover the basics. Debt consolidation combines some or all of your debt into a single debt obligation. It's beneficial if you have substantial debt or are paying high interest rates. Often, these types of debt include:

Credit cards

Medical bills

Car payments

Payday loans

Here's how it works

First, you'll use your debt consolidation loan to pay off this high-interest debt. Then, you'll make fixed monthly payments toward a new loan — typically at a much lower interest rate. As a result, debt consolidation makes managing your finances easier and less stressful.

The benefits of debt consolidation

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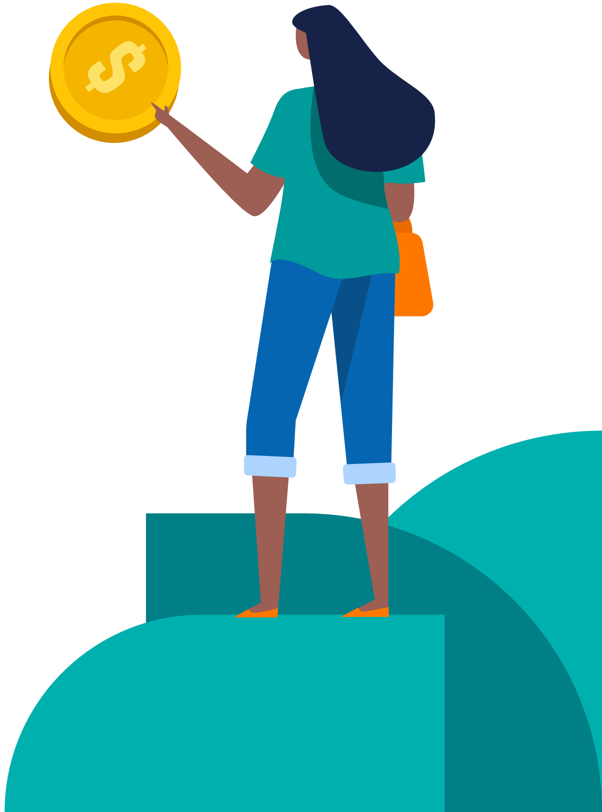
Consolidating debt offers plenty of benefits. While each person's situation is unique, here are the most common benefits that can come from consolidating debt:

1. **A defined timeline**
   Unsecured debt often has no timeline for an eventual payoff, which can cause a lot of stress. One of the benefits of consolidating your debt is a structured timeline with a clear endpoint for when you'll pay off your debt in full.

2. **A single monthly payment**
   Juggling multiple monthly payments is stressful. By combining your debt, you're effectively paying off all your creditors, leaving you with one manageable monthly payment. Plus, with a fixed amount, you know exactly what you'll pay each month.

3. **A lower payment**
   It's likely that your debts carry various interest rates, some of which may be exorbitant.The higher the interest rate, the higher the payment. With a debt consolidation loan at a fixed, lower interest rate, your new monthly payment may be lower than your current payments. This could also help you pay off your debt sooner.



The benefits of debt consolidation

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4 **Less risk of owing fees**

It can be difficult to keep up with monthly payments if you have more than a handful of credit cards or other debts. Not only is this stressful, the fees associated with missed payments can add up. With debt consolidation, you'll owe one monthly payment rather than several. With that, your financial life will be much more manageable and you'll worry less about missing payments.

5 **An improved credit score**

Your credit utilization rate accounts for 30% of your credit score. To calculate this number, compare your total credit availability to the amount you typically use. When you pay off high-balance credit cards by consolidating your debt, you reduce your utilization ratio. Over time, this will help to improve your credit score.

Related articles

What is a good credit score?

A step-by-step guide to debt consolidation

Expert tips for paying off credit card debt

Are you a good candidate for debt consolidation?

If you're juggling multiple debts, interest rates, payments amounts and due dates, you may be a good candidate for debt consolidation. **Other questions to ask yourself:**

Is your debt secured or unsecured?

Secured debt has an asset behind it, a piece of collateral like a home or vehicle. Unsecured debt does not. Instead, unsecured debt relies on the borrower's creditworthiness and tends to be riskier for the lender. Because of this, unsecured debt often means higher interest rates and payments.

Types of unsecured debt include:

- Medical bills
- Student loans
- Outstanding credit card balances
- Personal loans
- Utility bills

How is your creditworthiness?

Before extending credit or issuing loans, a lender must determine a borrower's creditworthiness. Creditworthiness helps the lender determine an individual's suitability for a new loan or credit card. It also helps them assess the likelihood of the borrower defaulting on that debt. To measure your creditworthiness, lenders will review how you've handled credit in the past, as evident through your credit reports. They'll note things like your repayment history, credit score and current debt-to-income ratio.

Are you a good candidate for debt consolidation?

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What’s your debt-to-income ratio?

Your debt-to-income ratio is the sum of your monthly debt payments divided by your gross monthly income.

For example: If your gross (pre-tax) pay each month is $4,000 and your monthly debt obligations (rent, car payment, student loans and credit card payments, etc.) total $1,800, your debt-to-income ratio is 45% ($1,800 ÷ $4,000 = 0.45).

This ratio is a key factor when creditors calculate your creditworthiness, ability to repay a new loan and the amount of credit they’re willing to extend. The lower the ratio, the more likely you are to get approved for the loan you need.

Related articles

Secured vs. unsecured loan: what to know before you apply

Six tips that could improve your credit score

The best types of debt to consolidate

Technically, you can consolidate any type of debt. However, certain types, like unsecured debt, are better suited to debt consolidation because of their higher interest rates and monthly payments. Here's a look at the best types of debt to consolidate:

Credit cards

Americans held over a trillion dollars in credit card debt in 2020. According to Experian, "The average balance on a credit card is now almost $6,200, and the typical American holds four credit cards." Often, these credit cards charge upward of 20% interest, making credit card debt one of the best types of debt to consolidate.

Medical bills

CNBC reports that in 2020, "Almost a third of working Americans currently have some kind of medical debt," with around 28% of those owing $10,000 or more. It's for this reason that medical bills are generally a type of debt worth consolidating.

Payday loans

Essentially, these cash advance loans exist to float money to cash-strapped individuals until their next paycheck. Payday loans are usually issued in small amounts (no more than $500) paid back with a steep fee — typically ranging from $10 to $30 for every $100 borrowed. This can mean those small, short-term loans end up with an APR 20x that of a credit card. If you have outstanding payday loans that roll over every two weeks, consolidating them at a significantly lower interest rate could immediately benefit your financial health and well-being.

Types of debt consolidation loans

There are several ways to generate the funds to consolidate and pay off your debt.
Let's take a look at two of them to see which is best for consolidating your debt.

Home Equity Line of Credit (HELOC)
If you're a homeowner who's built up equity in your home by making monthly mortgage payments, you may be eligible to borrow against that equity. Being a secured loan, a HELOC may offer you lower interest rates than other types of loans, making it one of the best options for debt consolidation.

A HELOC works like a credit card, only it uses your home as collateral. You can withdraw as much money as you want from your line of credit, and you can use this money for whatever you want, including debt consolidation. Lenders determine your credit amount through many factors, including:

- The total amount of equity you've accumulated in your home
- Your current income
- Your credit score

Keep in mind

You'll need to practice financial discipline to use a HELOC for debt consolidation. You should only withdraw an amount that you know you can pay back. Avoid overextending yourself by taking on additional revolving debt from the home equity line of credit.

Types of debt consolidation loans

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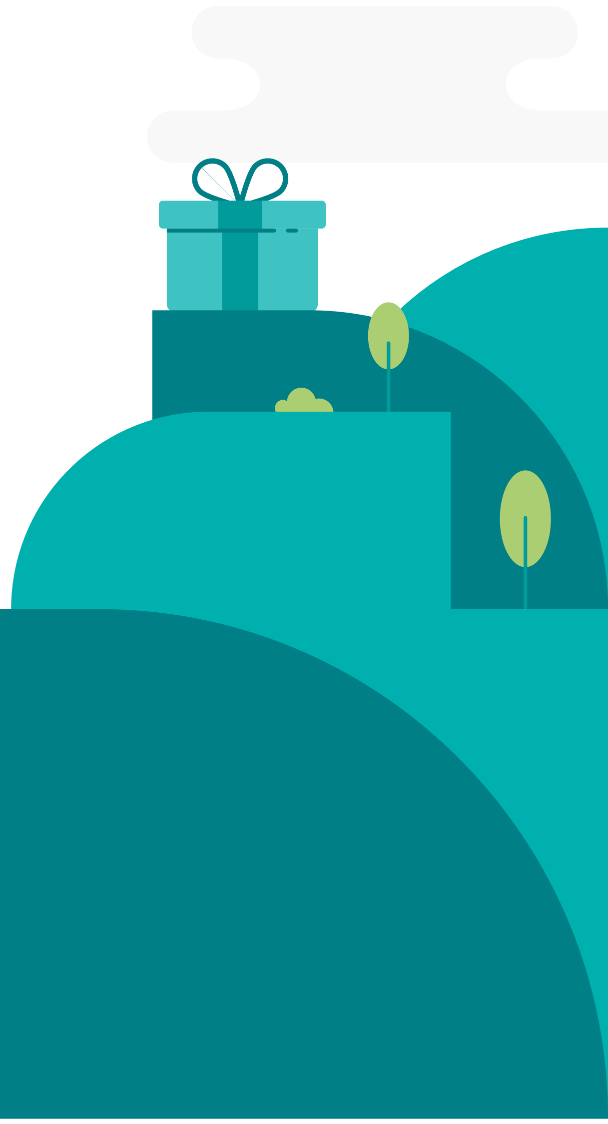

Personal Loan

A personal loan is typically an unsecured loan that you pay back in fixed monthly payments over time. You can use the money from a personal loan or many purposes, including debt consolidation. Borrowers with good credit will get the lowest personal loan interest rates.

It’s important to note that using a personal loan to consolidate debt may extend your repayment terms, meaning it could take longer to pay off your debt. This isn’t necessarily a bad thing, but something to keep in mind. Just make sure that the new personal loan offers a lower interest rate than the debt you’re consolidating.

Related articles

3 ways to consolidate credit card debt

Using a personal loan to pay off a credit card

How to use home equity for debt consolidation

Is student loan consolidation smart?

Conclusion

We’ve covered a lot here. Now, you should have a better understanding of debt consolidation and how it could help you. The next step is to determine whether it’s the right solution for you.

To find out if you’re eligible and what interest rate you might qualify for, **apply for a debt consolidation loan today**.