When To Consider A Debt Consolidation Program

Should you Consolidate?

There are several things to consider when deciding if you should consolidate debt.

What is Debt Consolidation?

Debt consolidation, in its simplest form, means taking several forms of debt and consolidating them into one payment. For example, say you have three private student loans and one government student loan. A debt consolidation program would combine those four separate loans into one loan with one payment.

What a Debt Consolidation Program Doesn’t Do

A debt consolidation program does not make your debt go away. While it usually results in one lower monthly payment, you still have the same amount of debt you had before and it still must be paid off.

How to Know When to Consolidate Debt

In addition to student loans, here are a few scenarios to consider when consolidating debt:

* Home equity loans or lines of credit. If you have a home equity loan or line of credit with a higher interest rate, you may be eligible to roll everything into one mortgage at a lower rate, depending on the total loan amount and your home’s appraised value.
* Debt on high-rate credit cards or department store cards. If you have debt on several credit cards that are charging higher than normal rates, you can usually get a loan with a lower interest rate to pay off those credit cards.
* Other unsecured debt. This could include medical bills or unpaid taxes.

Debt Consolidation Mistakes to Avoid

Don’t mistake a debt consolidation program for a debt management program. Do your research and make sure that the program you are applying to will actually help you consolidate rather than just manage payments. And don’t fall for any slick sales pitch that promises relieving you of all debt quickly. If it sounds too good to be true, it probably is.

Also, know how debt consolidation will affect your credit score. For example, let’s say you have five credit cards with a credit limit of $2,000 each or $10,000 total credit available. On each card, you carry $1,000 in debt, for a total debt of $5,000. Your credit utilization ratio is $5,000 out of $10,000, or 50 percent.

Now say you take out a loan for $5,000, pay off all credit cards and close those accounts. You have a loan for $5,000 with a credit limit of $5,000, or a credit utilization ratio of 100 percent. This can hurt your credit score.

Next Steps

When researching debt consolidation programs, keep the following in mind:

* Find out the minimum and maximum dollar amounts required to consolidate debt.
* Find out the interest rate and loan length of the new loan. Make sure that you’re not paying a consolidated loan for a longer period of time, resulting in higher overall interest paid.
* Find out if the lender has any credit requirements, such as a minimum credit score or if they exclude prior bankruptcies.