Use the Equity in your property to consolidate your high interest rate debt into a single low interest rate debt payment .

All that you need to know about

Debt Consolidation

by Kishore Masand

A lot has changed over the past few decades.

Factors like technological advancements, launch of newer products at an unprecedented pace, continuous human desire for comfort, convenience & connectivity, changing lifestyles, and an ever-evolving social & economic world have drastically changed the way we earn and consume.

Lower interest rates and easy availability of credit have brought a large range of products & services within reach of a vast majority of the population thus helping improve life standards.

However, things can sometimes go against plans leaving people in a difficult spot. Income loss, unexpected health issues and economic turmoil can at times make people take on debts which may get difficult to manage. Difficulty in management of debt repayment could lead to a few missed payments which leave a negative impact on the credit score. Reduced credit score in turn makes the borrower less desirable to major lending institutions further complicating the financial scenario.

This is where debt consolidation comes to the rescue.

WHAT IS DEBT CONSOLIDATION

Debt consolidation is the process of replacing existing loans with a new loan.

Normally people get a new loan to pay off several smaller existing loans to bring all these debts together into one combined loan with one monthly payment. Since this is bringing multiple debts together and combining them into one loan, this is referred to as "consolidating" them. That's why it's called a debt consolidation.

In real terms, debt consolidation does not mean combining existing loans and then generating a new combined single loan from the existing loans. It basically means replacing existing loans by paying them off. This is done by getting a new loan which would be used to pay off the existing ones.

Normally the new loan is procured at a lower interest rate, and/or at favorable terms, and/or with a longer repayment period thus reducing the monthly payouts.

Debt consolidation should generally attain two objectives
1.Reduce Interest Obligation
2.Reduce Monthly payments thus improving cashflow for the borrower.

DEBT CONSOLIDATION USING EQUITY IN THE EXISTING HOME

Home is the biggest asset for any home owner. Over the past few years, home prices have climbed to levels unseen in the Canadian real estate history.

This continuous rise in prices has improved the net worth for all Canadians owning real estate.

Historically low interest rates have further fuelled the rally in home prices and have also made the dream of owning home a reality for most Canadians.

These ever-increasing prices, which have generated lots of equity in homes, and historic low mortgage rates make home refinancing a great option to pay off high interest debt owed on other products.

The process of combining all high interest debt and paying that off by digging into the equity of existing home has become most sought after option for majority of Canadians.

Availability of a variety of lenders like Banks, Trust companies, Credit Unions, Mortgage Investment Corporations and many others, make it possible for any kind of a borrower (irrespective of their credit scores, income levels or age) to tap into their home equity to pay off high interest debt with a low interest mortgage payment.

Products like refinance of existing mortgage, Home Equity Lines of Credits, second and third mortgages etc. offer many different opportunities to home owners to pull out equity in the most cost efficient manner to pay off high interest debt.

Contact your mortgage / banking specialist to explore various options which may help you improve your financial situation.

ADVANTAGES OF USING EXISTING EQUITY FOR DEBT CONSOLIDATION

1. Lower Interest Obligation:

Current low interest scenario has made borrowing against homes, a very attractive option. Any form of funding against the property be it a mortgage, home equity line of credit, or a 2nd / 3rd mortgage, in most scenarios, is much cheaper than high interest credit cards, unsecured lines of credits, payday loans etc.

Repaying high interest debt and replacing that with a low interest loan secured against a home reduces the interest liability significantly thus improving the financial position.

2. Lower Monthly Payments and Better Cashflow:

Real estate secured products are generally amortized (life of a loan) over a longer duration. This higher amortization along with a lower interest rate mean a lower and, in most cases, a significantly lower monthly payment.

Lower debt repayments leave more money in the hands of the homeowners thus improving their monthly cashflow substantially.

3. Simplification of finances:

Debt consolidation makes life easy in terms of managing finances. Rather than paying multiple debts on different dates, one loan with one payment makes managing finances much easier.

Instead of having many debt payments to keep track of and pay on time every month, borrowers now have only one to manage.

Single debt repayment as opposed to multiple repayments can also improve borrower's credit by reducing the chances of making a late payment or missing a payment on multiple debt products.

4. Pay off debt faster:

Debt consolidation using equity in the property can help pay off debt faster. This normally works as borrowers obtain a lower interest rate than what they were paying prior to debt consolidation.

If they keep their current monthly debt repayment almost or exactly the same as it was before consolidation, more money would go towards paying debt and lesser amount goes towards interest repayment.

Additionally, some unsecured debt products allow borrowers to make interest only payments, which means that borrowers keep paying interest only while their original debt amount never goes down. However most real estate backed loans are repaid as a combination of interest and principal repayment weaved together. That way borrowers would always be reducing their original debt amount as some portion always goes towards debt repayment.

5. Can Improve Credit Score:

Debt consolidation using the equity in the property can help in improving the credit score in many ways. First managing one payment as opposed to multiple payments is much easier and the chances of missing debt repayments reduces significantly.

Secondly paying off revolving debt products like unsecured lines of credit and credit cards, can reduce the credit utilization rate (amount outstanding against the limit on the debt facility e.g an outstanding balance of $4,000 on a credit card having a limit of $5,000 would have a credit utilization rate of 80%, 4,000/5,000 x100) reflected in the credit report.

A high credit utilization negatively impacts the credit score irrespective of repayments. Even if a borrower makes agreed payments each month but has a high utilization against the credit limits granted by the lender, the credit score would go down. However, that does not happen with mortgages and loans as they are not revolving debts but loans.

Making consistent, on-time payments and, ultimately, paying off the loan can improve borrower's score over time.

Debt consolidation comes with several benefits and is a great solution to fix the debt issues, however it is the not the guaranteed long term fix if the borrower does not have financial discipline.

The best way to resolve a debt situation is financial discipline. The borrower needs to understand what the underlying cause of the current financial problem is, if it is caused by factors beyond the borrower's control, then debt consolidation is a great way out but if the reason for the financial trouble is overspending or poor financial management then debt consolidation would only be a short term fix as such borrowers may again find themselves in the same problem over time.

Debt consolidation using equity in the property also involves certain costs like lender and broker fees, appraisal costs, lawyer costs etc.

However, debt consolidation is indeed a great solution in majority of cases and should be positively considered by anyone in financial distress.

It's always a great idea to reach out to a lending specialist who would assess the situation and offer a tailormade solution to the financial need.

ABOUT THE AUTHOR

I am a banking and financial professional with over 17 years of experience in the financial services industry.

I specialize in real estate secured lending both on the residential and commercial real estate.

Whether you are self employed, own multiple rental units, are new to Canada, are non residents of Canada or have a bruised credit, I have a mortgage solution for you. Over the course of my experience, I have dealt with possibly every type of borrowing requirement , and have perfected my craft in providing every solution possible to my valued customers, no matter how challenging their mortgage requirement may be.

I believe in treating my customers the way I would love to be treated, always striving to offer the best experience I possibly can.

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and I will be more than glad to assist.