Debt Management

In order to live comfortably in retirement, it is essential to reduce or, if possible, eliminate debt and to build up your personal wealth as much as possible prior to retirement. For some individuals, this is easier said than done, and this fact sheet attempts to assist you with a debt-free future.

Is all debt a bad thing?

Debt is not always a bad thing, as we often go into debt to purchase items we cannot afford at the time. As long as you remain in control of your debt and are able to make the repayments, then the debt is not usually a problem. Yet, if the debt starts to control you, such as when you have difficulties making the repayments, then action needs to be taken.

Is your debt out of control?

It is important that you acknowledge if you have a problem and need assistance. If you are in the situation of being in a large amount of debt and repaying the debt is an issue, it is essential that you advise your lenders immediately. Let the credit card company, bank, department store or finance house know of your circumstances and explain your problem so you can work out a repayment plan. If your problem is viewed as short term, such as an illness or an injury that has put you out of work for a few weeks, then a solution may be reached to defer your payments or extend the loan period, until you are able to afford the payments. Remember, it is in the interest of the lender or credit provider to help you work out how you can pay your loan as they want their money back as soon as possible.

Consolidation of debt

Individuals with different debts attracting various rates of interest are often encouraged to roll all of their debts into one loan such as their mortgage. This is called **debt consolidation** and is an attractive option because generally the interest rates for mortgages are significantly lower than those on personal loans and credit cards. The theory is that you can save on interest costs by rolling them into a single loan where you are forced to pay off part of the debt each month. However, it is essential to maintain the repayments to assist with reducing the loan.

Two points to consider are:

- If you are unable to stop borrowing money, then no amount of consolidation is going to help you reduce your debt and you will end up with a greater problem
- Before you consolidate your debts, make sure you know what the fees are. If there are no upfront fees the move may be worthwhile but remember to weigh up all the costs.

What should I look for prior to taking out a loan?

There are several things to look at and these include:

- What interest rate will be charged and how often do the payments need to be made - e.g. weekly, fortnightly, monthly
- How is the interest rate charged – i.e. is it a variable or fixed interest rate
- The actual amount, in dollar terms, that will be paid over the term of the loan
- Whether there are fees that increase the amount you pay over and above the interest payments, such as a maintenance fee

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- What is the interest free period on the loan
- What type of security is required to take out the loan
- What is the term of the loan
- What is the likely scenario if you are unable to repay the loan, or you experience financial difficulties
- Can you repay the loan over a shorter period and whether penalty rates are incurred if you do so
- Whether the contract is covered by the Consumer Credit Code.

Another point to consider is that several home loans are 'line of credit' accounts, which enable all your funds to be amalgamated into your home loan and then the repayments are then deducted from the account. This has the advantage of having greater amounts of funds in the account to reduce the interest payable on the loan. However, a disciplined approach is required to continue to make the ongoing repayments.

Further, you can use the interest free period on your credit card so as much cash as possible is in the mortgage account for as long as possible to reduce the amount of interest incurred.

Deductible versus non-deductible debt

Deductible debt enables you to claim a tax deduction on the interest incurred. An example of this is a negatively geared investment. In contrast, non-deductible debt is a debt that does not provide any tax concessions. An example of this would be a credit card debt or a home loan. It is generally more beneficial to extinguish non-deductible debt first due to the higher after-tax cost.

Can I talk to someone about my problems?

If you have spoken to your lenders and advised them of your situation, that is a good start. However, if you still need to speak with someone for some counselling, you can contact an organisation such as Anglicare Tasmania on 03 6213 3555 to speak with an experienced credit counsellor to create a plan for you to repay your debt.

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