Key Questions Before a Personal Loan

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Why do I need a loan?

The most basic question you should ask yourself before taking out a personal loan is “Do I need one?”. In general, we need to weigh up the benefits of taking on any new debt and make an informed decision before considering entering into any debt arrangement.

Can I pay back the loan?

Once you have weighed up your other options and decided that you need a loan the next step is deciding what amount of debt you can comfortably repay without placing unnecessary financial pressure against your current net income. You must take note that while it is easier to repay a loan for the same amount over a 5-year than a 2-year term , interest compounds monthly, so longer terms will generally include more total interest charged.

What is a personal loan?

As per MoneySmart website, this is how personal loans work: If you get a personal loan, you must repay the money you borrow within a specific time, usually 1 to 5 years. You also pay interest on the amount you borrow, plus fees and charges. All credit providers are required by law to lend you money responsibly. This means they must not lend you money if they think the credit is unsuitable for you.

To assess this the credit provider may look at your credit report and ask for:

- Payslips
- Bank account statements
- Copies of other credit contracts or bills

This is so they can verify your ability to meet any new loan repayments without financial hardship.

What are the types of personal loan?

- Variable personal loan
  A variable personal loan charges an interest rate that is subject to change. As such, your repayments may vary during the life of your loan. Many variable personal loans allow you to make extra repayments towards your loan to repay it early.
- Fixed personal loan
  A fixed personal loan charges a fixed interest rate, therefore, your repayments will not change over the entire term of the loan. Fixed personal loans offer stability. You know exactly how much your repayments are each month and can take this into account when budgeting.
- Secured personal loan
  Secured personal loans require you to put up an asset as security. Your security may be a car, boat, jewellery, art, business equipment etc. If you default on your repayments and fail to make appropriate arrangements with your lender to repay your loan, they have the legal right to take possession of the security and sell it to recover their money.
- Unsecured personal loan
  Unsecured personal loans do not require you to put up an asset as security. This makes them riskier to the lender, so they attract a higher interest rate compared to secured loans. If you fail to make your repayments, your lender can take legal action against you to recover their money.
- Debt consolidation loan
  A debt consolidation loan combines various loans you may have into one. For example, you may have two personal loans and an outstanding balance on a credit card, each with a different lender. Debt consolidation loans can enable you to consolidate all three into one manageable and potentially more affordable loan.
- Overdraft
- An overdraft is a loan attached to a bank account, giving you access to additional funds, up to an approved limit. By linking the overdraft to your bank account, you have easy access to these funds via online banking and ATM withdrawals.

Source: CreditSavvy

What are the fees involved in getting a personal loan?

Fees vary depending on each Lender. Here are some common types of fees to look out for:

Loan approval fee

Once your loan has been approved, your lender may charge you a one-off loan approval fee. It covers the cost to the lender to arrange and administer your loan and it is usually added to your loan balance.

Ongoing fees

Ongoing fees, or service or administration fees, are charged on a regular basis (e.g. monthly, quarterly, yearly) throughout the term of your loan. It covers the cost of maintaining your loan.

Early exit fees

If you have a fixed rate loan and make extra repayments or repay your loan in full before the end of the loan term, your lender may charge you an early repayment fee.

Interest rates?

Some personal loan providers use so called risk based pricing, which basically means that the riskier they think you are, the higher the interest rate you are paying for your loan.

It should be noted that when you see an advertised rate from such providers, this is the generally the rate for their best customers.

Note that if it's advertised as rates 'from x% p.a.', this may not be the rate you might end up paying. So, it is always good to know where you stand before you apply and make sure you are loan ready.

How to apply for the loan?

Many banks and lenders these days are able to approve a loan pretty quickly and make the money available to you on the same day. Generally, you'll find that if you have a pre-existing relationship with a bank, that bank might be more inclined to approve you quickly without too much paperwork.

When you check out the different loans available make sure you take into account any additional charges like set-up/application fee and ongoing fees, which may make a big difference in the effective interest rate you are paying. A good indicator for this is the comparison rate.

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