Debt Consolidation Strategies for Healthcare Pros

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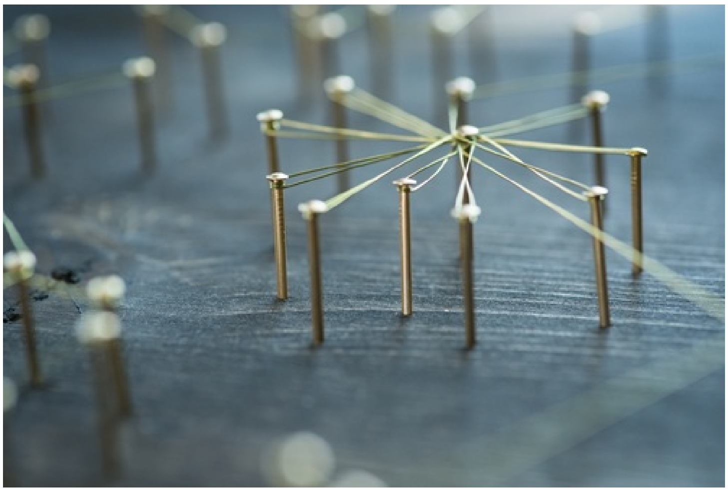

Australia's appetite for debt has been increasing over the last 10 years with household debt currently at 187% of household disposable income and about 20% of middle income Australians have no room in their budget for unexpected expenses.*

For healthcare professionals, this is often in addition to a substantial debt for the higher education that means they are paying higher tax – so there is added incentive to watch your dollars.

For some, debt might be as simple as a single credit card, for others it can be multiple sources. If you are paying off debt to multiple sources, consolidating the debt and paying a single low interest rate may assist.

If you have two or more of the following there may be a simple debt consolidation solution:

- One or more credit cards in debt
- home loan
- car loan
- personal loan
- any loans or store credit cards with short-term interest-free periods you've acquired on assets such as furniture or white goods

The home loan approach

If you've got a home loan, you may be able to use this loan to pay off your other debts. Sounds odd – but it's not magic and you'll still have to pay the full amount back, you'll simply save on interest. What you have to be mindful of is that any short term debts that are consolidated into your mortgage can result in compounded interest over the life of your mortgage which can be as long as 30 years.

Example

Troy and Mary are getting married. They've got a home-loan and big families to please for their forthcoming wedding. While they've tried to keep costs for the wedding down, they want to make their families happy and they extended the guest list leaving them with a credit card bill of $20,000.

The interest on the credit card is 18%. However, the interest on their home loan is only 5%. To ensure they don't pay the high interest for the credit card, Mary applies for a re-draw of $20,000 from their home loan. Though there are some restrictions on amount (eg $30,000) and a short waiting period (eg 3 days), most home loans will allow you to redraw money you've already paid off on your home loan.

Since Troy and Mary have been diligently paying off their home loan for over a year, they have adequate funds they can redraw.

In the normal course of things Troy and Mary would have expected to pay off the credit card over two years as most of their income goes to the home loan. Here's how it could play out if they did or did not consolidate.

With Consolidation	Without consolidation
$20,000 debt	$20,000 debt
5% interest	18% interest
2 year payment plan	2 year payment plan
$20,970.88 principal and interest paid over 2 years	$23,609.42 principal and interest paid over 2 years

By paying only 5% interest on the $20,000 through their home loan rather than 18% through their credit card, Troy and Mary save $2,638 provided they are disciplined and the original $20,000 loan principal is repaid over the 2 year period.

Planning for a re-draw

If you are about to acquire a home-loan it can be good idea is to apply for an amount in excess of what you need, eg $50,000 more. Once you acquire the loan, you immediately pay off the $50,000 thus giving you a generous redraw facility. Of course, if you're using every dollar you've got to make the minimum deposit or meet the loan to deposit ratio, then this is not an option.

If your loan has penalties associated with early payments or redraws, this approach may be a bad idea. You should check the fine print of your loan beforehand. If you weren't able to do this, you can still approach your bank for a home loan extension/top-up to acquire the finance to consolidate your debts.

The debt consolidation loan

Banks and other financial institutions offer debt consolidation loans. This can be attractive if you have multiple debts.

Example

David moved interstate for a dream job, however, he's been forced to move out of his parent's home. He acquires a personal loan to cover the relocation costs and gets a car loan as he'll need a vehicle to travel to and from his new job. In the relocation he purchases a few pieces' of furniture after seeing a 12-month interest-free period (deferred payment) advertised at a furniture shop.

10 months later, David finds that a fair proportion of his income is being paid out to cover the car loan and personal loan. He has also amassed a small debt on his credit card and if he can't pay the full amount for the furniture he purchased with a 12-month interest free period, he has to pay the interest to cover the whole 12-month period. David resolves to do something about this before the 12-month period ends.

David's debts

Debt	Interest rate	Interest paid after 24 months	Interest paid after 5 years
$9,000 car loan	7%	$1,252	$3,132
$2,000 personal loan	15%	$592	$1,482
$6,000 furniture	30%	$3,512	$8,781
$4,000 credit card	18%	$1,419	$3,547
$18,000	**n/a**	**$6,775**	**$16,942**

Assumptions: 5-year term for all debts with minimum monthly payments.

In order to pay less interest on these debts, David gets a debt consolidation loan. A debt consolidation loan may have an interest rate of about 15%. This rate is similar to a personal loan but far lower than both a credit card and what he'll pay on a department store card for a 12-month interest free period deferred payment option. The car loan is likely to be lower, so there is no financial benefit in consolidating this debt in this scenario.

David's debts after consolidation

Debt	Interest rate	Interest paid after 24 months	Interest paid after 5 years
$9,000 car loan	7%	$1,252	$3,132
$12,000 consolidation loan	15%	$3,556	$8,889
$18,000	**n/a**	**$4,808**	**$12,021**

By consolidating his debts David saves

- $1,967 over 24 months
- $4,921 over 5 years, in interest payments

When consolidating any debts, you should check if there are any early payment penalties. While most modern loans are simplified and removed heavy restrictions for early and extra payment, it is worthwhile checking, otherwise you may find that consolidation leads to paying more.

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*Reserve Bank Data and Digital Finance Analytics reported in ABC Online 15 Feb 2017

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