Refinancing or debt consolidation

fact sheet

phone: 1800 007 007
www.debtselfhelp.org.au

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This document is for general information and is not legal advice.

Overview

Some financial institutions and private companies promote refinancing your loan and consolidating your debts as ways to make your debts more manageable. However, if you're in financial hardship, you need to read the fine print if you are considering these options. You may, in fact, end up paying more under the changed arrangements than you would have in your original loans.

Refinancing involves cancelling your current loan agreement and entering into a new loan agreement with your current lender or another lender. Debt consolidation usually means getting a new loan or varying an existing loan to pay out a number of other loans. You should talk to a financial counsellor before making a decision on refinancing or debt consolidation.

The effects of refinancing or consolidating debts

Most people refinance or consolidate debts in an attempt to make their loan repayments more affordable in the short-term. However, the cost of your new loan (including interest, fees and other charges) must be significantly lower than what you have been paying for this to be an effective debt management strategy.

Bear in mind that if you have recently lost your job or experienced reduced income it is unlikely that a lender would be offering you a less-expensive loan.

If you consolidate loans, you may end up with fewer debt payment options if your difficulty is ongoing. For instance, you will not be able to negotiate payment plans for individual debts and you may not be able to access specific hardship programs. (See various fact sheets on the Dealing with Debt page.)

Advantages and disadvantages

People usually consolidate debts to:

- Reduce monthly payments;
- Manage a single debt instead of several debts, all with different conditions, terms and payment dates;
- Save money when the interest and costs are lower overall than the interest and costs of the old loan arrangements.

Refinancing or consolidating debts may seem attractive options in the short-term. However, they may have disadvantages when viewed over the term of your loan including:

- You may have to pay exit fees to get out of existing loans early.
- The fees and charges of setting up and maintaining your new loan may be more expensive than if you had kept your existing loan/s.

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- If you change your unsecured debt into a debt secured over your home, your equity in your home will be reduced and you'll be paying off the debt for a longer time, making it more expensive.

How to compare loans

You need to check the costs of your current loan against its cancellation cost plus the set-up and ongoing costs of any new loan before you decide to refinance or consolidate your debts.

You should consider:

- Interest rates
- If the loan has fixed or variable interest
- All fees and charges for the life of the loan
- Monthly payments over the life of the loan
- Applicable exit fees
- Any other available options to reduce your debt
- Any security required under the loan agreements

Using your mortgage to refinance or consolidate debts

If you are ahead with your mortgage payments, you may be able to re-draw against the mortgage to pay out loans with a higher interest rate.

It may be less costly to transfer all of your other debts to your mortgage account and extend its term than it would be to refinance into a whole new loan. In the longer term, you may be able to fast-track paying off the extra debt when you get your finances under greater control. This way you can reduce the overall costs of the loan. You might also increase your loan repayments by as much as you can afford, or if you find yourself with extra money, make a special loan repayment.

If you are not ahead on your mortgage, increasing it by adding other debts would need to be thought through carefully (see Traps of Refinancing below). You may have other options. Talk to a financial counsellor.

Traps of refinancing (and watch out for dodgy lenders and brokers)

Getting deeper into debt

Consolidation can get you even deeper into debt by letting you borrow more money. For example, if you transfer your credit card balances onto your home loan, you might be tempted to put new debt onto your credit cards. If the consolidation loan simply increases your overall level of debt, you are making your financial problems worse.

Losing your assets and your family and friends

Before you turn all your unsecured debts (such as credit card debts) into a secured debt (using an asset such as your home as security), remember that your assets will be on the line if things go wrong. If your fact sheet

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home is jointly owned with someone else, they will have to pay your debt if you can't.

Dodgy lenders and brokers

There are brokers and lenders that take advantage of people who are desperate to save their home. They do this by:

- Charging them high fees, sometimes more than 20% of the equity in their home
- Arranging a refinancing agreement where it is extremely unlikely that the borrower will be able to afford the new repayments. This is called 'equity stripping' and has landed a lot of people in hot water financially.

Equity stripping can be very lucrative for brokers and lenders, as they can make big profits at minimal risk. Some lenders have been known to charge borrowers 50% interest or more, and higher rates if they default on the loan.

Here are some warning signs that your broker may be dodgy:

- They ask you to sign blank documents or credit application forms with false information in them
- They arrange a business loan for you when you only want a basic consumer loan
- They do not discuss your financial situation in detail before arranging a loan
- They do not explain fees, charges and repayments before you sign up
- They tell you not to worry about reading the paperwork
- They advertise that they can help you no matter how desperate your financial situation.