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5 QUICK WAYS TO GET INTO DEBT AND DEBT CONSOLIDATION

Does it seem like your debt keeps growing? If so, you're not alone. The average U.S. household with credit card debt has an estimated $7,236 in revolving credit card balances, based on a Lending Tree article from November 2024. Here are some easy mistakes that can cause debt to pile up, along with tips on how to limit on what you owe.

Mistake 1: Collecting credit cards. Consumers are bombarded by offers for credit cards, but don't be tempted! Once you get a new card, it's easy to use it, which could lead to spending more than you intended—and more than you can afford. Running up credit card balances will only increase your debt and the amount of interest you will end up paying. The solution is to be strategic: Don't charge more than you can afford to pay off each month. Stick with one card and don't sign up for any new ones.

Mistake 2: Paying only the minimum. Even if you can't currently afford to pay off your entire credit card balance, paying as much as possible each month will help minimize your interest costs and save you money over time. It may seem easy to pay only the minimum required, but this is a costly error. Be sure to check your credit card statement for more details on the life of the balance paid at the minimum amount.

Mistake 3: Not budgeting or saving. It's easy to overspend if you don't know how much you have available to spend each month, which is why creating a spending plan is so important. Add up all your monthly income and then subtract all your monthly expenses. Adjust your spending if your income doesn't cover your expenses or make plans for how to allocate any money left over if you earn more than you spend. A budget can also help you spot and trim unnecessary expenses or expenses that are higher than you realized. Be sure to make room in your budget for establishing and maintaining an emergency fund so you don't have to borrow to cover unexpected costs or use credit cards to pay for everyday expenses. (Check out our article "Building a Better Budget" in this Kit.)

Mistake 4: Spending tomorrow's money today. This is spending money that you do not actually have yet. Say you lose some part of your income, but you don't change your spending because you think you'll probably be able to replace that income soon. In the meantime, you rack up debt, and it takes longer than you thought to restore your income—which can lead to even more debt. Another mistake can happen when you are expecting to get some extra money, say in the form of a new higher-paying job or a windfall of some kind, and you start spending now as if that money were already in the bank. In both cases, the best approach is to adjust your spending to reflect the funds you have today.

Mistake 5: Not rewarding yourself for your accomplishments. You know that minimizing debt has many benefits, but you're more likely to succeed if you celebrate a little when you've finally reached a milestone, such as paying off a credit card or lowering your debt by a certain amount. Don't break the bank but do consider giving yourself a night out or some other small treat. A reward will help motivate you to keep going until you are debt-free and make it less likely that you'll slip up and overspend again.

Should You Consolidate Your Debts?

Whether you're trying to improve your money management, want to lower your monthly loan payments or just can't seem to keep up with all your credit card bills, you may be looking for a way to make debt repayment easier. Debt consolidation may be the answer.

What is debt consolidation?

Debt consolidation is when you roll all of your smaller individual loans into one large loan, usually with a longer term and a lower interest rate. This allows you to write one check for a loan payment instead of many, while lowering your total monthly payments.

Ways to Consolidate Debt

- **Balance transfer to a low-interest rate credit card:** Most credit card companies allow you to transfer balances by providing them with information such as the issuing bank, account number and approximate balance. Or, your credit card company may send you convenience checks that you can use to pay off your old balances. Keep in mind, however, that there is usually a fee for this type of transaction, and the lower rate may last only for a certain period (e.g., six months).
- **Home Equity Loans:** Most banks and mortgage companies offer home equity loans. You'll need to fill out an application and demonstrate to the lender that you'll be able to make regular monthly payments. Your home will then be appraised to determine the amount of your equity. Typically, you can borrow an amount equal to 80% of the value of the equity in your home. Interest rates and terms for home equity loans vary, so you should shop around and compare lenders. There are costs associated with obtaining the home equity loan, so you'll have to evaluate the cost versus the interest savings.
- **Personal Loans and Consolidation Loans:** Some lenders offer loans specifically designed for debt consolidation. Again, you'll need to fill out an application and demonstrate to the lender that you'll be able to make regular monthly payments. However, these loans usually come with higher interest rates than home equity loans and, depending on the amount you borrow, may require collateral on the loan (e.g., your car or bank account).

Advantages and Disadvantages of Debt Consolidation:

Advantages

- Lower monthly payments than combined payments of smaller loans or credit cards
- Lower interest rates than credit cards
- One monthly payment instead of many individual payments

Disadvantages

- Collateral impact – lenders can repossess any collateral if you default on the loan
- Longer payment terms may mean paying more total interest and will take longer to pay off
- Temptation to use available funds once your debt is consolidated and credit is freed up
- Additional fees associated with balance transfers or HELOCs depending on the lender

Should you consolidate your debts?

There are several factors to consider when deciding on debt consolidation. It is important to consider the monthly payment, the interest rate, the timetable of repayment, and other factors. If the monthly payment on your consolidation loan is more than the sum of the monthly payments on your individual loans, consolidating may not be worthwhile. Moreover, the interest rate on your consolidation loan should be lower than the average of the interest rates on your individual loans. This allows you not only to save money but also to lower your monthly payment.