

Debt management

In order to live comfortably in retirement, it is essential to reduce debt and to build up your personal wealth as much as possible before retiring. The ultimate goal, of course, would be to eliminate all debt.

For some individuals, this is easier said than done. This fact sheet attempts to assist you with achieving 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. 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, it may be wise to 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 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.

Consolidation of debt

Individuals with different debts at 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:

- ▶ 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; and
- ▶ 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:

- ▶ The interest rate that will be charged and the required frequency of payments – e.g. weekly, fortnightly, monthly
- ▶ How the interest rate is charged – i.e. whether it is a variable or fixed interest rate
- ▶ The actual amount (in dollar terms) that will be paid over the term of the loan? If rates are variable, how can you know this upfront?
- ▶ Whether there are fees that increase the amount you pay over and above the interest payments, such as a maintenance fee
- ▶ What the interest-free period is on the loan (if any)
- ▶ The type of security required to take out the loan
- ▶ The term of the loan
- ▶ The likely scenario if you are unable to repay the loan or you experience financial difficulties
- ▶ Whether you can 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 the repayments are deducted from the account. This has the advantage of having a greater amount 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 beneficial to extinguish non-deductible debt first due to the higher after-tax cost.

Where can I get help?

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 the Consumer Credit Legal Centre to speak with an experienced credit counsellor to create a plan for you to repay your debt. The contact number in NSW is 1800 808 488.

Need further information?

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If you have any questions about the material covered in this fact sheet, please contact Chifley on 1800 800 002 between 9am and 5pm on any business day.

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