Money Management

Debt Consolidation

Are you scrambling each month to pay your credit card, school loan or other debt payments on time? According to the Federal Reserve Bank of New York, non-housing debt owned by American households reached $4.17 trillion in the fourth quarter of 2020. Whether it is paying off the high balances and interest rates of multiple credit cards or just simply trying to better manage your finances, debt consolidation may be an option for you.

What is Debt Consolidation?

Debt consolidation is the act of combining several loans or liabilities into one new loan. This allows you to pay off multiple debts through one centralized loan, providing a much simpler repayment plan and, in some cases, a lower overall interest rate. Debt consolidation, unlike a debt settlement, still requires that you pay off your entire debt to avoid negatively affecting your credit score.

There are two types of consolidation loans. A secured loan requires property to secure against the repayment of the loan. For example, a mortgage uses the house as security for repayment of the loan. In return for the use of an asset as collateral, the secured loan typically carries a lower interest rate, which can lead to lower monthly payments. This obviously puts the asset used as collateral at risk. Common examples of secured loan debt consolidation include refinancing your home, taking out a second mortgage and borrowing against your automobile as collateral.

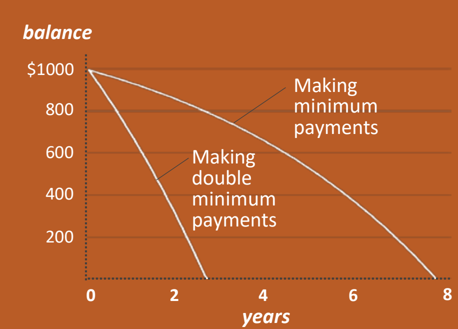
Unsecured loans, conversely, do not require a collateral asset to secure a loan. This increases the risk for the lender, which typically translates to a higher interest on the loan. While unsecured consolidated loans were more common in the recent past, today they require much better credit scores to qualify.

Direct Consolidation Loans for Students

After graduation, most federal student loans can be consolidated to simplify loan repayment, potentially lower monthly payments or offer alternative repayment plans. A common debt consolidation option is a Direct Consolidation Loan. Private education loans are not eligible for consolidation with a Direct Consolidation Loan.

Pay down debt faster

Paying just the minimum on a credit card can drag out the loan for years. Get rid of bad debt faster by paying extra each month.



For illustrative purposes only

Is Debt Consolidation for You?

Debt consolidation is not for everyone, and doesn't always equal savings. While lower interest rates and monthly payments may be a good short-term idea, it can also lead to paying more money over the lifetime of the consolidated loan. There is also an inherent risk that goes along with consolidating unsecured debt into secured debt.

Opponents of debt consolidation claim that it only treats a symptom, not the overall issue. What this means is that while it may be simpler to pay off a consolidated debt loan, it is up to the individual to truly master money management skills and avoid excessive amounts of debt in the future.

There are alternatives to debt consolidation. One method is the debt-snowball method, which calls for paying off your smallest accounts first while paying the minimum balance on larger accounts. After the smallest account is paid, you then move on the next smallest and continue until you've paid off your debt. If a self-reliant plan is not enough, other alternatives to debt consolidation include credit counseling, debt settlement and personal bankruptcy. It is important to note, however, that debt settlements and personal bankruptcy can negatively affect your credit scores and ability to acquire future loans.

Conclusion

Before you consolidate your debt, make sure you fully understand the benefits and potential pitfalls. Debt consolidation is not meant to be an immediate fix to your debt problems and comes with some serious trade-offs, including larger payments over the long term and potential loss of property. However, the simplicity of one centralized, manageable payment can provide the structure and lower payments to help your financial picture immediately.

■

[Prudential Advisors] [DBA Name]

[Name, designations per stationery guidelines]

[AR/CA Insurance License #]

[Phone]

[Email@prudential.com]

[PHP URL] [DBA Website URL]

Prudential

1002619-00003-00