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THE MORTGAGE CORNER

“Debt Consolidation Loans”

Often mortgage brokers are approached by clients who feel overwhelmed with debt that they have accumulated. The client may feel scattered by the number of bills coming in the mail each month, and with cashflow tapped out by various loan and credit card payments. They may wonder if it makes sense to consolidate their debt into a loan secured by a mortgage on their home (also called “refinancing”).

Consolidating with a mortgage may be a good idea if the reason for the debt was a one-time, or non-recurring reason – such as financing your children’s education, or doing home renovations that cost more than originally estimated. Consolidating may also make sense if the client realizes the debt they have incurred has resulted from over-spending, and they plan to change their spending habits in the future.

Consolidating amounts owed into significantly lower-interest mortgage loans can save a client thousands of dollars over the lifetime of the debt. This is definitely the case with the historically low borrowing rates we are currently experiencing.

As an example we’ll look at \$50,000 worth of debt over a 7 year period. At an average credit card rate of 19%, the payment to retire the debt in seven years would be \$1,059.37 per month – which would cost you \$38,987.08 in interest. On the other hand, the same money borrowed at a mortgage rate of 5% would cost \$705.49 per month, with an interest cost of \$9,261.16. That’s a difference of \$29,725.92 in interest cost over the seven years! So you can see that consolidating the debt into a lower rate may mean much more affordable payments and a huge interest savings in the end.

You would want to be careful to not extend the amortization of your consolidation loan over too long a period. The amortization refers to the total number of years the debt will be paid over, whereas the term of the loan is the period of time the rate is locked in. Extending the amortization over, say 10 years, would result in paying \$13,489.10 in interest, even at the lower rate of 5%. So you’ll want to keep the payments as high as you can afford, when paying off a debt consolidation loan.

Meeting with your mortgage broker can help you determine if a consolidation loan is right for you.

Midwestern Mortgage