

sorted

Debt

Taking on debt is too easy

- ✓ Strategies to pay off debt
- ✓ Seeing all your options
- ✓ It's okay to get help
- ✓ Know your rights



Taking on debt is too easy

When we borrow money, we get into debt. It can be helpful at first, but later it can become a drag on our finances that keeps us from getting ahead.

The longer your debt lingers, the more expensive it gets overall. That's because credit typically costs us in fees and interest – the price of borrowing money.

What is interest?

Interest is what we pay for using someone else's money. For example, if we borrow money from a bank, we pay the bank interest.

There are many ways to get into debt – credit cards, car loans, personal loans, mortgages... They all cost us money in fees and interest, and those costs can spiral out of control.

Getting into debt is easy. Paying it back is much, much harder.

Not all debt is bad. Borrowing money to buy a house or get an education can be a clever use of debt. Once it's repaid, we own the house or have a qualification that helps us earn more.

But some things are not so good to go into debt for, such as:

- Things which decrease in value, like appliances and cars
- Things which have no financial value afterwards, like a night out or a holiday
- Having too many things on buy now pay later – even though these sound good as being interest free, too many can be hard to manage

If you need to go into debt to buy a car that helps us commute to work and earn a living, ideally you would use as little debt as possible.

Joe gets on top of his debt

Joe has lots of different debts, and although he makes regular payments, none of them seem to be reducing fast. At the rate he's going, Joe feels like he can't see a future without debt.

While he knows roughly how much is owed on each of his debts, Joe has never given much thought to the interest rates and fees he's paying. He finds out the different interest rates on each debt by looking at the agreements he'd signed for each loan.

He then puts them in order from highest to lowest interest. His top priority debt is his credit card (which he used to buy a \$2000 flatscreen at 20.95% interest), followed by his car loan.

Joe takes another look at his budget and realises he could afford to spend another \$20 a week on debt repayments.

He sets up an automatic payment, increasing his credit card repayments by \$20 a week – double what he had been paying. Joe uses the debt calculator on sorted.org.nz and works out that the increased repayments mean he can pay off his credit card 69 weeks sooner. He'll also save over \$280 in interest.

More importantly, once he's got rid of that debt, he plans to add the money he was paying on his card to his car loan repayments. Now he's got a plan, he can start to see a time when he'll be debt-free.



Strategies to pay off debt

The longer we take to pay off debt, the more it will cost us. So we should try to get out of debt as fast as possible.

When you have multiple debts, instead of trying to repay them all at once, it's best to make the minimum repayment on all but one. Then you take as much extra money as you can find and use it to repay that one debt as fast as possible. Think of it like a fire extinguisher, putting out one debt after another. There are two ways you can do this:

The debt avalanche

With a 'debt avalanche', you pay off the debt with the highest-interest rate first. When you finish that, you move on to the next most-expensive one, then the one after that. Rinse and repeat.

The avalanche is the quickest way out of debt, mathematically speaking, since you are getting rid of the debt that is most expensive. When you do, you have more money to funnel towards your other debts.

If you are running some high balances and you find paying off large loans daunting, consider 'snowballing' your debts instead.

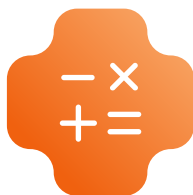
The debt snowball

With a 'debt snowball', you instead pay off the debt with the smallest balance first. Once that's out of the way, you take your extra money and aim it at the next-smallest balance. Again, rinse and repeat.

Knocking off the tiny ones first gives you motivation and momentum. Quick wins are satisfying!

Snowballing your debt isn't always the quickest or cheapest way out, but you may find it easier to build up momentum and make it to the finish line being debt free.

You may want to start with a snowball to get rolling and then start your avalanche later on. Whichever works for you!



Find out...
What's my true
cost of borrowing?

**Online tools at
sorted.org.nz**

Debt consolidation

This means wrapping all your debts together and paying them off with one lower interest rate. You take out a personal loan and transfer all your balances.

This doesn't always work out to be the cheapest option, as you may have the temptation to continue to your credit cards or store cards that you have just cleared. The key is to leave borrowing behind!

What about student loans?

Student loans are different from most types of debt. It's important to be careful and not borrow any more than we need, but as long as we stay in New Zealand, interest isn't charged. So just paying the minimum amount is different from other debts because it won't cost us more in the long run. Like all debt, though, it still needs repaying!

What's best for a mortgage?

Paying off a mortgage faster and saving money is definitely achievable – by shopping around for the lowest interest rate and paying as much as we can each month.

See the debt consolidation
guide and mortgage
guides on **sorted.org.nz**

5 steps to pay off debt quickly and be debt free

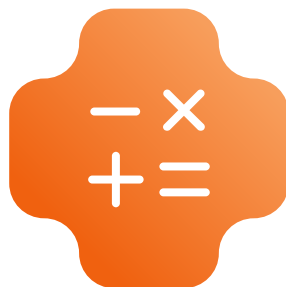
1. Find as much extra money as you can for repayments

Use the **budget planner** on **sorted.org.nz** to crunch your numbers and find as much extra money as you can. Even a little bit will help you get to your goal of being debt free that much quicker.

2. List all the debts you have, including their interest rate and balance

Attempting to pay them all off at once is daunting. You'll want to get a clear picture of all your debts, including how much they're costing you and how much they've grown. This way you can prioritise. You can use the **debt calculator** on **sorted.org.nz** to compile them all or list them below.

Name of lender	How much owed	Interest rate	Repayment
	\$	%	\$
	\$	%	\$
	\$	%	\$
	\$	%	\$
	\$	%	\$
	\$	%	\$
		Total	\$



3. Make minimum repayments as you aim your extra money towards one at a time

With a number of debts, you'll need to choose your strategy for which one to focus on. Start big with an **avalanche** (the highest-interest rate) or start small with a **snowball** (the smallest balance), and then aim all your extra money at that one until you're rid of it.

Order of debts:

How much extra money to funnel towards debt each month?

\$

4. Rinse and repeat with each debt you have

After you're done with the first, take all the money you had going towards it and move on to the next cab off the rank. One after the other, you will have more and more money going towards debt repayment, accelerating towards your goal.

5. Close out your credit to stay debt free going forward

All of this only really works if you fundamentally change the way you handle your money. Every time we use credit it costs us, keeping us from getting ahead financially. If your goal is to stay debt free going forward, you may need to close out the credit accounts you have.

Seeing all your options

Whenever we borrow, we need to make sure it costs us as little as possible. Even a small change in interest rate can make a big difference to the total amount we pay.

Going into debt is always a bit risky, since our circumstances might change and it becomes difficult to repay. Sometimes it's hard to tell what might happen.

There are many places that lend money. It may be cheaper to get a loan through a microfinance provider or a peer-to-peer lender online than borrowing through a store or car yard, so it's worth looking at all the options.

Looking for the best way to borrow? People tend to just focus on how much the minimum payment will be, but there are much more important questions:

- How much do we need to borrow, really?
- How much in fees and interest will we pay in total?
- How long will we be paying back the debt?
- How sure are we that we want to take on this debt?

The trick is to keep the full cost of the debt in mind as we compare (which the lender must disclose by law).

How to see the full cost before borrowing

Sorted's **debt calculator** on **sorted.org.nz** shows how much total interest will be charged on a debt.

Do we really need to borrow money?

Could we wait and save up the money instead? The more we do that the less borrowing costs us, and the faster we can get ahead.

How quickly could we save the money and avoid borrowing? Sorted's **savings calculator** on **sorted.org.nz** shows just that.

Check out the debt calculator and savings calculator on **sorted.org.nz**

It's okay to get help to become debt free

Debt is like fire – it can burn out of control, and it can become more than we can handle on our own. It's more than okay to get help!

If you fall behind on repaying your loan, you can be charged penalties in the form of fees or a higher interest rate. Your late payments will be recorded against your credit score (which affects your ability to borrow more someday) and even collection agencies get involved.

Trouble repaying?

If you're having some financial troubles and think you're going to find it hard to make the next repayment on a loan, go and talk to the lender straight away. You have the right to ask for new arrangements to repay and this is the best way to avoid extra costs.

You're not alone in this: reach out to the team at MoneyTalks, even anonymously, on:

- **0800 345 123**
- **help@moneytalks.co.nz** or
- text **4029**.

You'll be glad you got in touch – and may discover that there are even faster ways to get you debt free.

5 tips for buy now pay later loans

1. Think about the full cost

Buy now pay later loans like Afterpay or Zip can be tempting because we think about the upfront payment but we need to look at all the payments in total. What's the total cost of what you're buying?

2. Make only one buy now pay later purchase at a time

Try not to be tempted to take out more until the first is paid off.

3. Use buy now pay later to buy larger ticket items only

Only if you have to. Better yet, save up for it instead.

4. Set reminders in your phone

If you must take out more than one of these, list them all and set reminders in your phone when repayments are due.

5. Avoid late fees

Make sure to have enough funds in your account when repayments are due, so you don't get charged late fees. Missed or even late payments can mean massive late fees and penalties. And paying late can affect your credit rating too.



Check out the buy now pay later guide on **sorted.org.nz**

Know your rights

If you're ever concerned by the spiralling cost of your debt, or if you've bought a faulty product or even something you didn't really want in the first place, know that there may be options available.

Understanding your rights as a consumer can make a big difference should things go pear-shaped. Especially when it comes to the costs that debt brings, faulty goods or not-good-enough services, this becomes even more important.

Here are some places to seek help, understand you rights, make a complaint or find a solution to your situation:

- The Commerce Commission – understand your rights as a consumer
- Consumer Protection – range of advice on the the process of buying
- Banking Ombusman / Financial Dispute Resolution Services – dispute resolution
- Citizens Advice Bureau – know and understand your rights and obligations
- Community Law – free legal help
- Consumer NZ – make sure you're getting a fair deal

Notes:

Where to now?

- ✓ Borrow only what's needed
- ✓ Compare all borrowing options
- ✓ Make a debt repayment plan

Next steps:

e.g. calculate how much extra I can funnel towards debt repayments to get rid of it sooner.