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Debt

**Tackling it before
it's a real drag!**

- What to know before borrowing
- Seeing all the options
- The get-out-of-debt plan
- Quicker the better!



What to know before borrowing

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.

There are many ways to get into debt – credit cards, hire purchase, 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.

But 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

We might need to go into debt to buy a car that helps us commute to work and earn a living – but ideally we would use as little debt as possible for such a purchase.

So do we really need to borrow money and get into debt? 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.

Saving changes things

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

Help is available

Having to borrow money to pay for groceries or a power bill is a tight spot to be in. Expert budget advisers are available to help from the New Zealand Federation of Family Budgeting Services at **0508 BUDGET** (0508 283 438).

Trouble repaying?

If it gets difficult to repay, it's important to keep making the payments and tell the institution or person who lent the money as soon as possible. They may be able to work out a new repayment plan.

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.

Seeing all the 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 over time.

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.

How to pay less interest

Sometimes lenders can group high-interest debts into a single loan with a lower interest rate. This is called **debt consolidation** and can really bring down the cost of debt. It's great if we want to shrink our debt as fast as possible – as long as we don't add any new debts in the meantime!



The Get-out-of-debt plan

1. Debts:

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

2. Debts in order from highest to lowest interest rate:

Name of lender

1.

2.

3.

4.

5.

6.

3. Any extra money in the budget each month to tackle debt?

How much?

\$

4. Add this amount to the repayment for debt 1.

The new repayment amount for debt 1 is:

\$

5. Debt 1 paid off? Add that repayment amount to debt 2.

After debt 2, tackle debt 3, 4, etc.



Remember

A. If the lender won't accept higher repayments, we can skip that debt and increase the repayment for the debt with the next-highest interest.

B. If there's no extra money for debt repayment, we can wait until one of the debts is paid off, then add the repayment amount for that debt to the highest-interest debt.

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 hire purchase (which he used to buy a flatscreen), 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 contacts his hire purchase lender and explains his situation. The lender agrees to let him increase his repayments by \$40 a fortnight to \$78 - more than double what he had been paying.

Although Joe will have to pay a fee for paying his loan off early, it will be worth it.

Joe uses the debt calculator on sorted.org.nz and works out that the increased repayments mean he can pay off his hire purchase in 10 months rather than almost two years. He'll also save over \$190 in interest.

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



Quicker the better!

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.

What about if we're juggling several debts at once? The idea is to pay off the debt with the highest interest first (such as credit cards or personal loans). It's the quickest way out.

How to crunch the numbers

Sorted's debt calculator on sorted.org.nz lets us see how to pay back debt the quickest.

Here's the plan

- List all debts and the interest rate on each one. (The interest rate is in the credit contract, loan agreement or credit card bill.)
- Work out which debt has the highest interest.
- Make larger repayments to pay off that debt quicker. (Sometimes there are penalties for paying faster, so we may need to check.)
- Once that debt's paid off, start paying more off the debt with the next highest interest rate. The worksheet inside this booklet can help, or there's the debt calculator on sorted.org.nz.

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 mortgage guides on sorted.org.nz.

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!

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



Online tools at sorted.org.nz

Where to now?

1. Borrow only what's needed.
2. Compare all borrowing options.
3. Make a debt repayment plan.

Next steps:

e.g. talk to my lender to see if increasing debt repayments is okay.

Debt

Notes: