YOUR MONEY

MANAGING MULTIPLE LOANS

Lower interest cost via debt consolidation

SANJAY KUMAR SINGH & KARTHIK JEROME

The Reserve Bank of India (RBI), in its latest Financial Stability Report, warned that stress from consumer credit could spill over to secured loans. Data from the central bank revealed that many borrowers availing of credit card and personal loans also had home or vehicle loans running. A default even on a small unsecured loan could result in all the loans of that borrower being classified as non-performing. Here are strategies to help borrowers with multiple loans reduce their debt burden.

Merge multiple loans

Borrowers with multiple loans — such as credit card, personal, and home loan — can pool them into one large loan with a lower interest rate. "Taking a top-up loan on a home loan to pay off credit card dues and personal loans can significantly reduce the interest burden, as top-up home loans are much cheaper than the other two," says Vishal Dhawan, chief financial planner, Plan Ahead Wealth Advisors.

Interest on credit card dues ranges from 36–42 per cent, while personal loans range from 10–31 per cent. A top-up home loan costs slightly (0.5-1 percentage point) more than a home loan.

Other options for consolidation include loans against securities and loans against property, which are also more cost-effective than unsecured loans.

"Another advantage of secured loans is that they offer a longer tenure, which brings down the EMI and provides relief," says Arun Ramamurthy, director, Andromeda Sales and Distribution, and an expert in digital lending. Consolidating loans also makes things simpler operationally, according to Dhawan.

Nowadays, lenders also offer what are called debt consolidation loans. "They cost 12–14 per cent plus, with the exact rate depending on factors like the borrower's credit score and repayment tenure," says Adhil Shetty, chief executive officer (CEO), BankBazaar.com.

However, these loans often come with a few restrictions. "The agreement with the lender may state that the loan amount can only be used to repay existing loans. The borrower may also be restricted from borrowing further until this loan is repaid," says Shetty.

Pay highest-cost debt first

Another approach called the avalanche method prioritises paying off high-interest loans first. "Pay the minimum required on all loans to avoid default. Then use any surplus funds to clear the highest-cost loan, like credit card dues," says Dhawan. This is a cost-effective strategy.

Pay smallest loan first

Alternatively, borrowers can adopt the debt snowball method, which prioritises paying the smallest-sized loan. "This approach works well for those feeling overwhelmed by multiple loans," says Dhawan. Clearing the smallest loan provides a psychological victory and frees up cash for higher-cost loans.

Points to remember

Avoid borrowing further to prevent worsening your financial situation. Refrain from EMI-based purchases, even if they come with discounts. Shetty warns that defaulting can result in higher interest rates and penal charges, leading to a debt trap. Dhawan advises against risky investments in equities or cryptocurrencies as a way to escape debt. Be mindful of prepayment penalties, which many lenders impose. Do the math before proceeding.

Ramamurthy suggests monetising assets like gold, property, or mutual funds if you are on the verge of default. Safeguard your credit score as it is essential for access to loans in future. Once out of debt, ensure your EMIs do not exceed 30-40 per cent of your take-home salary. Finally, build a contingency fund equal to at least six months' expenses to avoid borrowing during emergencies.

WEIGHED DOWN BY DEBT? FOLLOW THESE BUDGETING TIPS

- Create and stick meticulously to a budget
- Assess all your income sources: salary, incentives, rental income, etc.
- Pay off fixed costs like EMIs, utilities, and school fees first; only the remaining funds should be spent during the month
- Before shopping trips, prepare a list of necessary purchases to avoid impulsive buys
- Prioritise within the list: Buy only what fits your budget, and defer the rest
- Cut back on discretionary spends like movies in cinema halls, dining out, etc.