How to Get Approved for a Consolidation Loan

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Overview

We're all guilty of it! All of the smaller credit cards pile up over time and eventually it becomes clear that the rates being paid on the respective cards are too high, as are all the minimum payments and the time it takes to manage all of those minimum payments. This is often when people start thinking about a debt consolidation.

Debt consolidation should carry the following benefits:

- Less interest
- Lower payments
- A single payment

Above are by far the top 3 reasons that individuals pursue debt consolidations. There are many different types of debt consolidations, offered by different types of companies. Each type offers pros and cons and has different requirements if you want to qualify.

This e-book will focus on what is required to qualify for an unsecured consolidation loan with a bank.

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Chapter 1: Types of Debt Consolidation

Types of Debt Consolidation

Before we can address how you can qualify for a consolidation loan, you first need to understand the different types of debt consolidations and who offers them so that you don't apply for something without first understanding what it actually is. Let's review some of the most common debt consolidations.

Unsecured Consolidation Loan – Finance Company

Finance companies like HSBC Finance, CitiFinancial and Wells Fargo offer debt consolidation loans (usually up to $15,000-$20,000). These loans are usually written over 4-6 year terms. The biggest problem with these consolidation loans is that they almost always bear very high interest rates – anywhere from 20%-35%. This type of consolidation loan will give you the benefit of a single monthly payment, however after you are finished paying interest you could end up repaying 3x what you owed in the first place and it may not end up being cheaper than the rates you were paying on your credit cards.

Unsecured Consolidation Loan – Bank

Banks are obviously the most affordable choice if you want to obtain a debt consolidation loan. Typically speaking, banks will offer consolidation loans one of two ways: a personal line of credit or a term loan. Personal lines of credit often bear lower interest rates than term loans and banks definitely prefer issuing lines of credit over loans.

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Consolidation Loan – Mortgage

There is one big catch if you want this type of debt consolidation – you have to own a house and have some equity in it. If you don't, then you won't qualify for this type of consolidation loan. If you do, using a mortgage to consolidate debt can offer the lowest interest debt consolidation financing but you have to be careful to watch out for closing costs.

Once you have paid appraisal, legal, broker and admin fees and balanced that against the interest you are paying for the consolidation – the cost may end up being higher than it would have been had you sought an unsecured line of credit from the bank. Mortgages can be amortized over 25 years so you can also negotiate very low monthly payments – but this is a double-edged sword because the longer it takes you to repay, the more interest you end up paying in the long run.

Consumer Proposal

Consumer proposals don't work like traditional debt consolidations in that you do not actually borrow the sum that you owe and then repay a new creditor a single monthly payment. A consumer proposal is administered by a trustee. Based on your income a proposal is made to your creditors. If the proposal is accepted, you make a single monthly payment to a trustee and then the money is distributed to your creditors. A consumer proposal will freeze interest, offer a single monthly payment and many times reduce the amount of debt that you owe. The biggest drawback with consumer proposals is that they have negative impacts on your credit.

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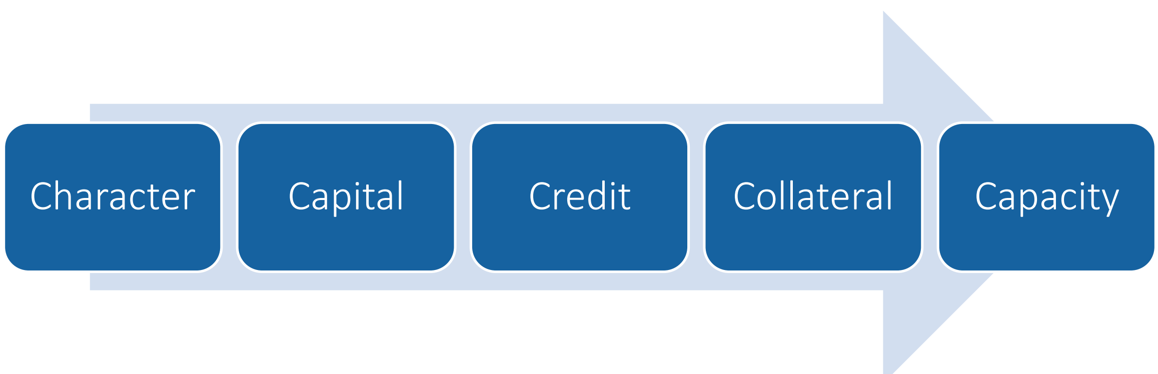
Chapter 2: What does the bank look for when you apply for a debt consolidation loan?

A bank will consider your debt consolidation loan based on the amount of risk that you represent to them. To assess risk they will look at specific criteria. In many financial circles these criteria are known as the 5 Cs of credit:



Let's look at each of the 5 Cs of credit, the thresholds that the banks look for in regard to each, and how they determine if you are a low or high risk in each category.

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Chapter 3: The 5 Cs of Credit

Character

Character will look at who you are. To determine character the bank will want to know things like how long you have lived at your residence, where you work, what type of job you have, and how long you have been employed. Typically the bank will want to see that you have lived and worked in the same place for 1-3 years.

If you have not, the bank will ask you for more background information like where you lived or worked previously. If you have moved around a lot for example, this could be a sign of weak stability and represent a risk to a lender. Character is also determined by how you pay your other obligations to creditors, bank account history (history of NSFs for example) and more…

Capital

Next, banks will want to see that you have some skin in the game. They will want to see that you have your own money saved and perhaps even some investments. If you don't have any money saved it is not a deal breaker but it certainly does represent risk to a bank if you have no other assets, such as a house.

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Credit

Ahh, the dreaded credit score. These days banks don't even really go through your credit report with a fine tooth comb and many will offer a system-generated approval based on your credit score and your credit score alone.

Your credit score is a number between 300 and 900 (300 being the worst and 900 being the best). Generally speaking, if your credit score is 680 or higher, the bank will consider you for a loan.

There are some catches, however, if your credit report reveals:

- Late payments in the past 24 months
- Credit cards that are close to, at, or over their limits
- Too many applications for credit in a short period of time.

These could represent a risk to a bank, and even if you have a 680 credit score you could still be denied credit.

Collateral

Collateral is fairly simple – what do you own that could be pledged as security on a loan? Usually the bank will look for things like a home or an investment and are not so interested in depreciating assets like vehicles. If you have collateral, this may cause the bank to approve a loan that it otherwise may not have. If you don't have collateral you may still qualify for a debt consolidation loan – you may just be approved for less than you would have if you had some form of collateral.

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Capacity

Capacity represents your ability to make monthly payments. The bank uses two calculations to determine capacity – these are TDS (Total debt service ratio) and GDS (Gross debt service ratio).

Here is how each calculation works:

TDS

Total household monthly payments + payments to credit cards and loans/income = TDS

- *The bank will want your TDS to be 40% or less (including your new loan payment)*

GDS

Total household monthly payments/income = GDS

- The bank will want your GDS to be 30% or less (including your new loan payment)

If either number is too high it may cause the bank to ask you for a co-signer or to prove that there is some other income present.

Capacity is also demonstrated by your ability to prove that you have the income that you say you do. If you are employed, the bank will want a letter from your employer and a paystub to validate your employment. If you are self-employed, the bank may ask you for several years of tax assessments to confirm your earnings. Failure to prove your income will almost always result in a rejected loan application.

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Chapter 4: Recap

In this recap, take a moment to review each of the 5 Cs of credit and consider whether you possess the attributes that the bank is looking for when determining if you will be approved for a debt consolidation loan.

Attribute	Requirement – Do you have it?	Questions
Character	o Stability o Reliability o Responsibility	o How long have you lived at your home and worked for your employer? o How do you manage your bank account and relationship with creditors?
Capital	o Some savings and/or investments	o What do you have? o Do you have savings and investments?
Credit	o Minimum 680 credit score o 24 months positive payment history o Not an avid credit seeker	Do you have: o Credit score minimum 680? o 24 months of clean payment history? o Credit cards that are not maxed out? o Less than 4 applications for credit in the past year?
Collateral	o Assets – home or vehicle	o Do you have anything that you can pledge as collateral on a loan?
Capacity	o Proof of income o Are your TDS, GDS ratios in line?	o Can you prove your income? o Is your TDS less than 40% and GDS less than 30%?

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Chapter 5: What to do if you don't qualify for a debt consolidation loan

Often individuals are declined for debt consolidation loan financing and feel backed against a wall because their credit cards have piled up; they want to pay but it is just too much. If you have been having a problem getting approved for a debt consolidation loan, this e-book has likely opened your eyes to some of the reasons why.

Listen, do you change the oil on your car yourself? Probably not! If you are in over your head financially and need a solution the best thing that you can do is speak to an expert about all of the financial options available to you. They may even be able to help you source a creditor that will extend debt consolidation financing when the banks won't.

They may have some other ideas to help you get rid of your debt so you can get back onto a firm footing.

Choosing a Financial Consultant

If you decide that maybe speaking to a financial consultant is the best choice here are some tips:

Ask lots of questions:

- How long have they been in business?
- How many employees do they have?
- Do they have an office?
- Do they only administer one service/ program or do they administer many?
- Do they have an online presence?
- Do they have recommendations/ client testimonials?

Author Bio

This e-book was written by Michael Goldenberg. Michael Goldenberg is the founder and President of DebtCare Canada Inc.

DebtCare Canada offers a service for those who struggle with debt. When Michael formed DebtCare Canada he refused to offer the typical 'credit counselling/debt services' offered by other credit counselling agencies.

Seeing that many bankruptcy trustees and credit counselling agencies are one dimensional, Michael formed a multi-faceted team.

A group of senior financial consultants, credit counsellors, advocates, accountants and in-house legal counsel offer clients a turnkey solution.

Currently, Michael's role as President of the organization has him establishing and negotiating strategic partnerships that enable DebtCare Canada to set a new standard in the financial consulting industry. Contact Michael at: mgoldenberg@debtcare.ca.

"Clients who come to DebtCare Canada all receive a free, no obligation consultation. Only in the event that they wish to take part in a program will there be a fee. The fee is nominal (one that most families can afford) and will not be payable to DebtCare until the client receives approval of the program."

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