How Do Debt Consolidation Interest Rates Work?

Anyone with a credit card knows how high interest rates can be, often above 20%, so there is no surprise that debt consolidation is a very popular option for debt relief in Canada. A debt consolidation loan frequently saves at least 5% on interest rates, sometimes more. Of course, this will depend on your credit rating, so those with a good credit rating may be able to lower their average interest rate more than 10%.

For instance, if your average interest rate is currently 10%, and you get a debt consolidation loan that reduces your interest rate by 5%, that instantly reduces your interest paid by half. This allows you to receive a lower monthly offer, or continue paying what you have been to pay it off faster.

It is recommended that you learn a little about debt consolidation loans, as with any other debt relief program in Canada. This will assist you in knowing all of your options, and choosing the best one for your situation. There are various debt consolidation loan types that calculate interest rates differently.

**Variable-Rate Vs. Fixed-Rate Loans**

When applying for debt settlement plans, the loan rate type is not usually an important factor, but when you’re searching for debt consolidation loans it is best you understand the types of loans. There are two key types available with consolidation loans: variable-rate loans and fixed-rate loans.

**Variable-Rate Loans**

This type of loan will have an interest rate that occasionally changes over time. This will cause your minimum payment amount to change based on the changing interest rate. This can be beneficial if interest rates decrease, but if the average rates increase so will your payments.

**Fixed-Rate Loans**

This type of loan offers a single interest rate that will last the entire length of your loan term. This allows you to know exactly what your payments will be over your entire loan term, and minimum payments will not increase. No matter the way market rates fluctuate, the interest never changes, which means if the average rates decrease, you still pay the same.

Both fixed-rate and variable-rate consolidation loans will be available to you, whether you’re going through a professional credit counselling service or negotiating your own debt consolidation loan.

**Types of Debt Consolidation Loans**

You will have an option between variable-rate or fixed-rate interest on all debt consolidation loans, but there are still multiple types of consolidation loans, including:

**Consumer Loans**

This is an unsecured personal loan. Typically, consumer loans need to be paid off for avoiding consumer proposal or bankruptcy filing, but when it can be an option to use as debt consolidation. Of course, this is only if your credit score is good enough to qualify and get a better interest rate than your current average interest rate. Consumer loans are available with either a variable-rate or fixed-rate interest.

**Home Equity Line of Credit**

Typically, this type of loan will have a variable interest rate. It is a secured loan through your home’s equity. It’s a revolving credit line, and those with poor credit ratings may not qualify.

**What is Revolving Credit**

A revolving cred line refers to a loan which allows you to reuse the open balance amount once a portion of the loan has been paid off. For example, credit cards are a type of revolving credit.

If approved for a $50,000 Home Equity Line of Credit, you can use $20,000 as debt consolidation, leaving $30,000 available. After paying back $5,000 on the HELOC, you would have $35,000 available to use.

Unlike traditional loans that you pay back until it’s closed, revolving credit means you get to reuse as needed.

**Second Mortgage**

A second mortgage loan borrows against your home’s value, while retaining your initial mortgage. This will result in having two different mortgage payments, but if you’re able to get a lower interest rate and pay off your consumer debt, it may be worth it. Interest rates can be variable-rate or fixed-rate.

**Home Refinance Loans**

It is common for people to apply for a home refinance loan well above what they actually require for paying off consumer debts. This can be beneficial if the interest is lower on the refinance loan, which comes in variable or fixed interest rates.

**How Are Interest Rates Set?**

Predicting interest rates for debt consolidation loans can be done by reviewing the bond market and prime interest rates. When consolidation loans are a type of mortgage loan, the bank will set a variable rate by subtracting several percentage points from the prim interest rate. Meanwhile, they base a fixed interest rate on the bond market. Banks take the current bond rates issued by the Canadian government and add 1-2 percentage points for the total.

A consumer debt consolidation loan could use the same mortgage loan pattern above, but different banks may have their own method for calculating the interest rate. Either way, you often pay a higher interest rate with poor credit compared to good or excellent credit scores.

**Is Debt Consolidation Right for Me?**

You should always review all of your options, for help fill out our debt relief form. We will have a professional reach out to you with further information.