Factors to Consider Before Taking a Loan

Everything has become fast these days and taking a loan is no exception. Nowadays, you can apply for a loan a lot easier than ever before.

But does it mean that repaying a loan also has become more comfortable? The answer is, however, in the negative.

There is no need to say that when you take a loan, you need to repay it. You need to settle your loan by paying the monthly installments ultimately. As such, it becomes your financial liability as you need to pay the installments from your income.

So, there are enough reasons to assess not only your financial situation but also a slew of factors before you eventually sign up for a loan.

1. Purpose of the loan

Loan purpose is the reason you want to borrow money. It's always important to carefully consider your financial situation before taking on a loan, sometimes a loan is the best way to finance a large purchase or project that you can't afford upfront.

Example reasons to get a loan

- Vehicle financing

A loan is one way to cover the cost of your required vehicle. Using a loan is better than depleting your savings or emergency funds when paying for larger expenses.

- Home remodeling

Home owners can use a loan to upgrade their house or complete necessary repairs, like fixing the plumbing or redoing the electrical wiring.

- Emergency expenses

If you have a sudden unforeseen emergency, like paying for a loved one's funeral, using a loan could be a low-cost option. Surprise medical bills are another common reason to take out a loan. After you've negotiated with the hospital, doctor, and insurance company, you might need a personal loan to cover unexpected medical costs.

- Business expansion

There could be sudden business expansion that is vital to sustain. Your existing funding lines could be insufficient to meet the new expense. Obtaining a business loan could be the best way out.

2. Type of Loan

You should decide on the type of loan you want to take according to your purpose, as many types of loans are readily available in the market such as Mortgages, vehicle loans, Personal, Gold, Micro, Business loans among others.

Different types of loan products have various features that could suite your requirement and repayment pattern. Certain loan products can be taken for longer time periods that reduces your monthly financial commitment.

Therefore, once you decide to obtain a loan, it is better to refer few banks, finance companies to understand the available product range.

3. Interest Rates

Loans do not come for free. You need to pay the interest. Therefore, you should do some study on the interest rates of different lenders and you should eventually select the lender that offers the lowest interest rate.

Keep in mind that the total amount of money you will need for repaying the loan depends on the applicable interest rate. Lower interest rates will keep the repayment amount within reasonable limits.

4. CRIB status

Your crib status has a decisive role to play when you apply for a loan. Therefore, make sure that your crib is free from any strains as many lenders will assess your credit history before approving a loan.

If you find any problems with your credit score, get in touch with the credit company to fix the issue. If your crib is irregular, make efforts to improve it so that you qualify for higher loan limits.

5. Repayment Term

Check out the repayment period for the loan. Keep in mind that the repayment period also determines the total cost of the loan. Also, make sure that you make the monthly repayments on time, or else you will face penalties from your lender.

6. Your Financial Situation

One of the essential points of consideration before applying for a loan is your financial position. Keep in mind that you should go for a loan which you can repay without straining your finances.

Ask the question “Do I really need this loan? What are the alternatives I have without taking a loan?”

If not necessary, avoid taking large loans as that will attract more fees and higher monthly installments. Go for a loan that you can comfortably repay.

7. Your Debt-to-Income Ratio

Your debt-to-income ratio is an essential consideration if you have any debt. It is your monthly debt obligations as a percentage of your monthly income. The lower the ratio, the better are the chances of lenders approving your loan and you can repay the loan comfortably.

8. Value of Your Collateral

Collateral is an asset that you need to keep with your lender as security. You have to give the guarantee to your lender through the collateral that lender can recover money back if you fail to repay loan installments.

The value of the collateral determines the amount of money you can borrow. For instance, if you take a home loan, you cannot borrow more money than the current value of the home (which usually acts as the collateral for home loans).

The rationale behind collateral is that your lender needs an assurance that the loan money can be recovered if you default on the loan.

You can obtain credit facilities even without collateral. However, the lender would charge higher interest rate for same.

9. Liquid Assets

You should check whether you have some money as saving in your bank account and assets that you can easily convert into cash. If you have such liquid assets, it will help if you encounter a setback, such as losing your job suddenly. You will be able to repay your loan until you get back on your feet.

10. Identify Other Loan Alternatives

Loans are not always the only option to get away from emergencies. You may consider borrowing money from family and friends. This way, the entire hassle of paying interest could be removed, and even if you pay them interest, there won’t be any prepayment expenses.

At some point you might decide to dispose an existing asset and generate some money for your requirement.

11. When not to use a loan

While a loan is a useful tool to finance larger or unexpected expenses, there are some situations where it may not be the best option. Before applying, consider your financial situation and the reason for taking out the loan. Individuals for whom a loan would not make sense would include anyone with irregular crib, not enough repayment capacity .Etc

Lastly,

If you're on a tight monthly budget, a loan may not make sense for you. Some may find that the payment on a loan would be higher than their various minimum payment requirements combined. This can potentially leave you with more accumulating debt and a cash flow crunch.

Apart from the points shared above, identify the credibility of the lender from which you borrow. Make sure that the financial institution has a good customer support and give you a flexible tenure to repay the amount. Last but not the least, opt for loans only to meet your financial goals and be sure of your ability to make repayments.