

## Which is best for dealing with debt: credit cards, loans or overdrafts?

Feature

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*It's likely that now and again you'll need to go into debt to cover one-off expenses. So what is the wisest option? Christine looks at the individual pros and cons of credit cards, loans and overdrafts.*

The UK is now officially a nation of borrowers. According to the latest Bank of England figures, British consumers currently owe £58,152 billion on credit cards and £153,584 billion in other unsecured debt.

But, with the **cost of living rising faster than most people's pay cheques**, it's hardly surprising most of us need a helping hand now and again. So if you must go into the red, what's the best way of doing so? Which is the lesser of the three evils: **credit card**, personal loan or **overdraft**?

Of course, it all comes down to the specific circumstances you find yourself in. We asked three experts what advice they would give people facing four common dilemmas.

***Check out our new best buy tables for credit cards and loans giving you a comprehensive guide to the best products available.***

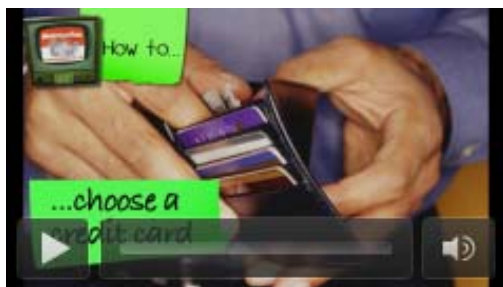
### SCENARIO ONE: HOLIDAYS

The warmer weather is nudging your thoughts toward a summer holiday. The problem is that by the time you've saved enough to pay the £1,500 for your dream trip, summer will have passed you by. How can you finance a much-needed break before winter comes round again?

Our experts voted in favour of using a 0% purchase credit card. "It won't cost you a penny in interest charges to pay for your holiday this way - as long as you play by the rules," says Andrew Hagger, spokesperson for Money.net.

Kevin Mountford, head of banking at moneysupermarket.com, agrees. But he warns: "You need to make sure you'll be able to repay the amount in full by the end of the promotional period - otherwise you'll end up paying a higher rate of interest."

Credit cards also have the benefit of being without early repayment charges, which means you'll have the flexibility to clear your balance as soon as you can. M&S Money currently has



### How to choose a credit card

a 0% deal for 15 months; paying back £1,500 over this timescale would cost you £100 a month.

### SCENARIO TWO: NEW CAR

With growing children to ferry around, your little run-around no longer fits the bill and you need a bigger car. You've found the perfect model, but it costs £10,000. So how do you pay for it?

"£10,000 is likely to take quite a few years for most people to pay back, and the interest applied to a loan will be much less than a credit card," says Peter Chadborn, director of **IFA** firm Plan Money.

Moreover, with a large sum like this, you'll probably want to spread your monthly repayments over a number of years. This makes a personal loan, where the interest rate and monthly repayments are fixed for the duration of the loan, the most appropriate way of financing the purchase of your new motor.



### How to choose a personal loan

Bear in mind, however, that there'll normally be an early repayment charge - meaning you will have to pay extra (usually two months' interest) if you want to clear the loan before the end of its term.

Hagger says if you have a big enough credit card limit and the garage will allow you to pay by card, it could be worth making the initial

purchase by credit card on a 0% deal and then transferring the remaining balance to a personal loan once the interest-free period expires.

The current market-leading personal loan rate from Sainsbury's Finance is 6.8% for borrowing £10,000 for five years. Repayments and interest would cost a total of £196.12 a month and you would pay £1,767 in interest over this term.

### SCENARIO THREE: A NEW KITCHEN

You're planning to extend your kitchen but it's going to cost around £25,000 and your savings won't cover this. What options are there?



### Should I get a personal loan or use a credit card?

Chadborn suggests taking out a loan. "But in order to make the payments more manageable, rather than getting an **unsecured loan**, you should consider a further advance on your mortgage," he says. "This is justifiable because a good quality kitchen will likely add to the value of your home."

"**Remortgaging to raise extra cash** is harder these days, but it should still be possible as

long as you have a fairly modest loan-to-value," adds Melanie Bien, director of independent

mortgage broker Private Finance. "Don't extend your total LTV above 75%, as this would be reflected in a much higher rate."

You could get 4.39% fixed for five years with a £495 fee from Yorkshire **Building Society**. If you prefer a tracker, HSBC has a lifetime deal at 2.39% (1.89% over bank **base rate**) with no fee, but the maximum LTV is 60%.

#### SCENARIO FOUR: STRUGGLING TO COPE

You've been hit by a string of unexpected expenses, leaving you around £150 short each month. How do you manage in the short term until you're back on track?

"Using an authorised overdraft to fund short-term expenses can be beneficial, especially if it's an account with no charges or fees," says Mountford.

The Preferred **Current Account** from Santander offers an overdraft of up to £5,000 with no daily fees for 12 months. It's the only account that currently offers 0% interest (typical overdraft rates are between 16% and 18%), but you'll have to pay at least £1,000 into your account each month.

Hagger says a 0% credit card is also an option: "It's just this sort of cash-flow situation that your plastic or overdraft facility was designed for."

However, if you're constantly struggling at the end of each month, the best course to follow is to take a good look at your finances and budget where necessary.

#### Credit cards

If you're able to clear your credit card each month - or you have a 0% purchase card and you can comfortably clear the balance before the 0% period expires - credit cards can be a useful way of managing your finances.

There are also plenty of rewards to be had with many credit cards, from cash-back to air miles.

It can also help improve your chances of getting further credit in the future: if you show you can use your card responsibly your **credit score** will increase.

But problems occur when you can't clear the balance and the card's standard interest rate kicks in. Missing monthly payments or paying them late can incur penalties, usually around £12.

Even if you're making the minimum payments, if your card has a typical interest rate of between 15.9% and 17.9%, you may find it difficult to make any headway clearing the balance.

Also be careful of surcharges: when you use your credit card, the vendor may in some cases charge you between 1.5% and 3%.

#### Personal loans

Providers offer personal loans of between £1,000 and £25,000 for any purpose you want. Rates are currently quite competitive, typically between 8% and 13% for a £5,000 loan

repaid over three years and between 6.8% and 8.8% for a £10,000 loan repaid over five years.

A plus point is that the interest rate you'll pay is fixed. Once you've agreed a rate when you take out the loan, you'll know the amount you're paying each month until the loan is repaid. Loans are also pretty quick to access, and can often be up and running within 24 hours.

But there are downsides. If you want to repay your loan early, you'll usually be stung by an early repayment fee - typically around two months' interest.

You'll also need a good credit rating to be approved for a loan with a decent rate, and you'll have to stick to the repayment schedule. Miss a payment and you'll incur a penalty - usually around £25.

### **Overdrafts**

Overdrafts are handy if you find yourself slipping into the red every now and again. They work well for people who need a little extra for just a couple of days at a time, rather than a certain amount for a specific reason.

There is no repayment schedule for overdrafts, so you're not committed to repaying a certain amount each month.

However, you'll usually be charged interest on your overdraft. Typical interest rates are between 15.9% and 17.9% for authorised overdrafts (where the limit is agreed with your bank), and around 29.9% for unauthorised overdrafts.