DebtAdvice Foundation

A Registered Charity - Number 1095705

BEGINNER'S GUIDE TO DEBT

What is Debt?

Financial debt is the money owed by one person (known as the debtor or borrower) to another (known as the creditor or lender). In return for letting someone borrow their money, often referred to as a loan, the lender receives extra payments on top of the original amount borrowed. This is called interest.

Without the person who is borrowing the money agreeing to pay extra, it's unlikely that the person lending the money would be as willing, as there's a chance they may not get their money back. Interest is the price of borrowing money.

As well as agreeing to pay interest on the loan, the borrower must also agree to pay it back by a certain date. Usually loans are paid back in equal monthly amounts.

Why do people get into debt?

People borrow money for a variety of reasons, sometime because they need to (to buy a car to travel to work for example) and sometimes because they want to (perhaps for a holiday). The biggest amount of money most people will ever borrow is to buy a house.

It's also important to recognise that as well as borrowing money, a person can also get into debt by not paying their bills, such as their rent, electricity or gas.

Is all debt bad?

No. There's no such thing as good or bad debt, although it can be very serious if you borrow more than you can afford to pay back. Debt and borrowing money is actually an important part of our financial system. If no one ever lent any money then very few people could buy their own homes. Also, if they weren't able to borrow money then people with good ideas might not be able to buy the tools & materials they need to start their own businesses (many of the things we take for granted such as games consoles and mobile phones would possibly never have been developed).

If you find yourself struggling to keep up with repayments, what happens next will depend on the type of debt and who you owe the money to. In some circumstances, the people you owe money to can make you Bankrupt and even take your home off you. That's why it's so important to think long and hard about whether you can save up instead of taking out a loan. If you do decide that you want to take out a loan, you need to make sure that you can definitely keep up with repayments.

It might sound like an easy thing to do, but what if your circumstances unexpectedly change:

- **What if you lost your job or become too ill to work?**
- **What if you or your partner got pregnant?**
- **What if the price of food, electricity or petrol increase so much that you no longer have any money spare to pay towards your debts?**

No one can predict the future, which is why it's important to remember the ABC of borrowing:

Affordability – can you afford the repayments now and just as importantly, could you still afford them if the worst was to happen and you could no longer work?

Benefit – Do you really need it or do you just want it? Can you afford to wait as it will be cheaper in the long run if you save up? You won't have to pay any interest and you'll actually receive interest on your savings from the bank.

Consequences – Who are you borrowing the money off and what's the worst that could happen if you don't keep up with repayments?