

Sainsbury's Bank



Can I afford a loan?

You may want to apply for a loan for several reasons – for example to help pay for a car, fund home improvements or to consolidate your debts. But before you consider applying for a loan there is one fundamental question to ask: **can you actually afford one?**

This guide gives you some pointers to help you decide whether you can afford a loan, as well as other questions to bear in mind before progressing down this route. After all, a loan is not the only way to obtain credit.

Types of Credit

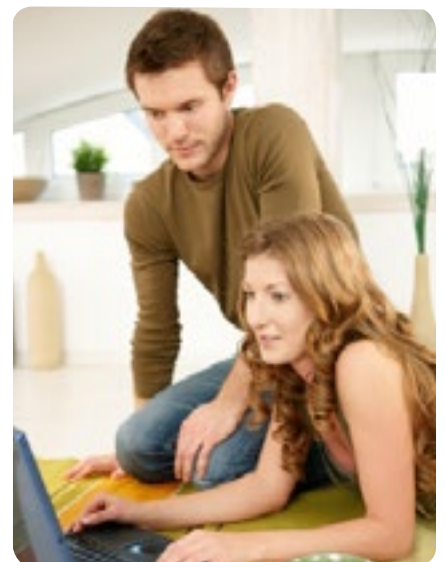
Personal loans are different from other forms of unsecured credit, such as overdrafts or credit cards because they consist of a specific amount of money that is paid to the borrower as one lump sum and repaid over an agreed period of time, at a fixed rate of interest. The lender charges you interest on the outstanding balance until the loan is paid back in full.

Doing your homework

Once you've decided that a loan is the right form of credit for you, you can start looking for one that might be suitable for your circumstances.

One rule of thumb is to ensure you have a good understanding of the product you are applying for, and to consider:

- Interest rates (APR)
- Length of the loan term
- Monthly repayment costs



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How much can you borrow?

A fundamental question to ask is: how much can I borrow over a certain period of time?

You will want to consider how much you think you need to borrow and how long it might take you to pay that amount back.

The **advantage** of borrowing over a longer period of time is that you can reduce the value of your monthly repayments yet the **disadvantage** is that the total repayment cost could be higher because the overall interest you pay will be higher in the longer term.

For example, borrowing £10,000 over four years at 5.1% will incur £1,050.56 in interest, whereas borrowing the same amount at the same rate over seven years would incur interest of £2,628.56.



Budgeting

A good place to start to work out what amount you could afford is to look at your monthly incomings and outgoings. You can then budget for a loan, according to available funds in your account. What are your living expenses? How much do you spend on rent/mortgage, food and clothing etc? The Money Advice Service has an easy to use [budget planner](#) to help you work out how much you might have available.

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Understanding the APR

When you're considering how much you can afford to borrow you should also factor in the amount of interest you will need to pay over and above the loan amount.

When you look at a personal loan advert or carry out an online loan quotation, the interest rate advertised is referred to as the 'Representative Example'.

This rate must reflect at least 51% of business expected to result from the advertisement or communication. However, the rate offered to each individual will depend on their personal circumstances, credit assessment procedures and other related factors.



Using a loan calculator

The final interest rate which you will be offered will depend on your own individual circumstances, but one way to get an idea of the total interest which may be due is to take the advertised rate and calculate a rough figure. An easy way to do this is to use a [loans calculator](#).

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When you enter the original loan amount (principal), the interest rate and the payback period you can see how much you may pay in interest and, therefore, how much you may repay in total.

Remember, you're only charged interest on your outstanding balance. For example, a £5,000 loan with a 5.1% APR and a one year payback term will accrue £137 in total interest, not £255 like you may initially think.

Knowing your credit rating or score

Prior to applying for a loan or payment plan, you can check your credit rating. This is based on your financial history and will help determine both your eligibility to apply for a loan and the interest rate which you are offered.

Credit reference agencies Experian, Equifax and Noddle offer detailed breakdowns of your credit rating. A tip is to check the information on your report is accurate and up to date. If you notice any errors, you can contact any past lenders you've dealt with and ask for errors to be corrected.



Improving your credit score

It's not just a poor credit history that can lead to you having a poor credit score; another reason might be that there is not enough information on your credit report for lenders to go on. For more information on improving your credit score, [check out our guide](#).

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Loan repayment period

Make sure you choose a repayment period that makes sense to you. Providers usually restrict the length of time in which to repay the loan; for example a minimum is usually six months or a year - right up to 84 months (or seven years). This, of course, depends on the provider, the amount to be borrowed and the borrower's eligibility.

How and when will you pay it off?

Consider the best time in the month for you to make the repayment. Is it just after your pay cheque or when another form of income goes into your account? Borrowers can also be mindful of outgoings alongside loan repayments such as a mortgage transaction, large energy bill or council tax.

Early settlement fees

Finally, find out whether you have the right to repay all or part of the loan at any time and whether there might be a fee for any early repayment.

Once you have all this information you should be in a much better position to determine what amount of money you can afford to borrow.

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The logo for Sainsbury's Bank, featuring a white wavy line that starts under the 'S' and ends under the 'k', with a small white circle at the end of the line.

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Links:

- 1) <https://www.moneyadvice.service.org.uk/en>
- 2) http://www.sainsburysbank.co.uk/borrowing/bor_borrowing_zone.shtml#tab-7500---15000
- 3) <http://www.uswitch.com/credit-reports/improve-credit-score/>

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