

Let's Talk...

Let's Talk ... About What to Know Before Taking Out a Personal Loan

Considering a personal loan? Personal loans can be a helpful financial tool, but it's important to understand what you're getting into, especially when the economic environment is uncertain. Here's a guide to help you make the best choice for your situation.

Evaluate Your Current Financial Situation

Before you apply for a personal loan, take a moment to assess your current financial situation and determine if a personal loan is right for you.

- **Current Income and Expenses:** Start by reviewing your monthly income and expenses. Are you living within your means? Understanding your cash flow will help you figure out how much you can afford to borrow and repay. If your expenses consistently exceed your income, it might be time to rethink your borrowing plans.
- **Existing Debt Levels and Credit Score:** Take stock of your existing debts and check your credit score. Also consider checking your credit report for accuracy. The Fair Credit Reporting Act requires the credit bureaus to make your report available to you for free once every 12 months. Visit AnnualCreditReport.com to request your copy. Lenders will look at your credit history when deciding if you qualify for a loan and determining your interest rate. A higher credit score can lead to better loan terms, which can save you money in the long run.
- **Purpose of the Loan:** Define why you need the loan. Whether it's for consolidating debt, financing a big purchase, or covering unexpected expenses, make sure the loan aligns with your financial goals. A clear purpose can help you avoid unnecessary borrowing.

Understand the Risks Involved

Defaulting on a personal loan means failing to meet the repayment terms outlined in the loan agreement. This usually happens when you miss one or more payments. Defaulting can hurt your credit score, increase your debt due to late fees, and even lead to legal action from lenders. It's essential to be confident in your ability to repay the loan before proceeding. If you're unsure, consider alternatives or seek financial advice.

Taking a loan when inflation is high also carries risks. The cost of borrowing can increase as lenders may raise interest rates to mitigate their own risks, leading to higher monthly payments and overall debt. Additionally, inflation erodes purchasing power, meaning that the

money you borrow today may not stretch as far in the future. The erosion effect may make it harder to repay the loan in the future as well.

Before taking a personal loan, first consider strategies to help reduce your current debt and evaluate if taking on additional debt is a good idea.

1. **Create a Budget:** Budgeting is a great first step in managing your finances. Track your income and expenses to identify areas where you can cut back and allocate more funds toward debt repayment.
2. **Prioritize High-Interest Debt:** Consider using the avalanche method, where you tackle the highest interest rate debts first. This strategy can save you money on interest payments over time and help you become debt-free more quickly.
3. **Consider Debt Consolidation:** If you have multiple debts, consolidating them into a single loan with a lower interest rate can simplify your payments and potentially reduce your overall interest costs. Just be sure to understand the terms of the new loan and ensure it doesn't come with hidden fees.
4. **Build an Emergency Fund:** Having an emergency fund can prevent you from relying on credit cards or loans in times of need. Aim to save at least three to six months' worth of living expenses to provide a financial cushion.

Need help deciding?

Check out Fidelity's article on the pros and cons of personal loans.

It may be tempting to consider taking a loan from your 401(k), but doing so can jeopardize your retirement savings and may result in significant tax penalties if you are unable to repay the loan. Before taking money out of a 401(k), learn more about the difference between loans and withdrawals.

A Fidelity Workplace Planning Consultant can help you make a plan during a complimentary one-on-one session. Call (800) 603-4015 or make an appointment online.

Sources:

[Federal Trade Commission: Free Credit Reports](#)

[CNBC: 10 questions to ask before taking out a personal loan](#)

[U.S. Bank: Personal Loans First-Timer's Guide: 7 Questions to Ask](#)

[Fidelity: How to Balance Saving, Debt and Investing](#)

Last updated date: 5/1/2025