Don't put balance transfer bandage on serious debt wound

By Josephine Lim

Balance transfer credit card offers can be hard to resist, especially as issuers compete for your business by offering super-low interest rates and transfer fees. Whether you have moderate or steep debt, paying low or no interest for a few months, or even a year in some cases, can seem like the answer to your problems.

But that's not always the case. Some situations are better suited for a balance transfer than others, and if yours isn't one of them, you could end up in a deeper debt hole.

When is a balance transfer advisable?
A balance transfer may be an option to consider as a part of a strategy to reduce your overall debt, rather than to avoid paying high interest on your balance, says Mike Chronowich, a financial planner with Ironshield Financial Planning.

"With personal debts levels so high, people [just see] the attractive rates," says Chronowich. "My perspective on this is to first build a comprehensive financial plan and see if this is a strategy fits within [your] overall goals. Sometimes, a

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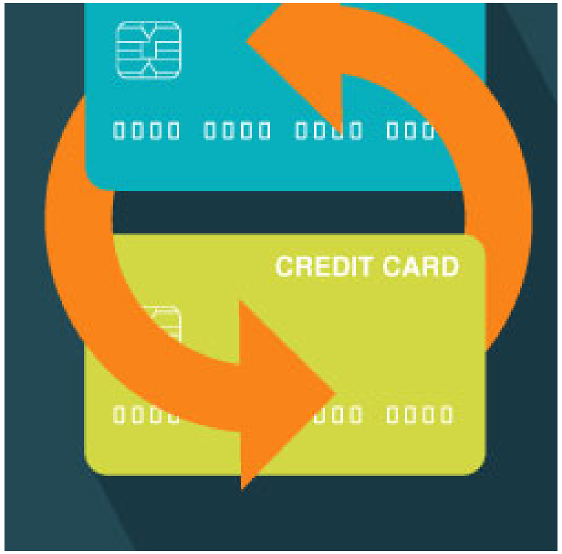
seemingly great offer to transfer your balance without doing the necessary due diligence may not leave you better off in the long run."



That plan should include your income, expenses and cash flow. Consider all your consolidation options as well, including lines of credit or a loan. Chronowich says the main factors he considers when it comes to balance transfers are the interest rate, the transfer fee and the length of the promotional period.

One situation in which a balance transfer is the best option is if you are guaranteed a major cash windfall soon, such as a tax refund or yearly bonus, says Bruce Thompson, a Regina-based Money Coach with Money Coaches Canada.

Additionally, if you're in a situation where the interest on your debt is the only thing keeping you from being able to pay it off in a short time period, a balance transfer is likely a good choice.

But each scenario comes with its own risks, and generally speaking, balance transfers are a last resort, Chronowich says.

When you shouldn't do a balance transfer

The danger with balance transfers is they don't solve the debt problem and can act as a bandage when you actually need rehabilitation, says Thompson. Sure, seeing all your debts in one place might give you a reality check and the kick you need to start paying and stop spending, but when it comes to personal finance, human behaviour also plays a major part, says Thompson.

Chronowich says he sees many clients who are stuck on a "merry-go-round" with balance transfers -- they transfer the balance and still can't pay it off in time, so they seek another balance transfer or end up paying the much higher interest rate once the promotion is over, leaving them back at square one.

Another danger is if you miss a payment, or make it late, even once, you might lose the promotional offer -- whether you're 11 months into the 12-month period, or one month in.

"I have to look at [my clients'] big picture," says Chronowich. "Are they ready to do this? Are [they] just going to be stuck in the same spot? If they miss that payment, sometimes the situation is worse."

Discipline plays an important role as well. Transferring the balance is going to make you see a $0 balance on your credit card, which could be dangerous for two reasons:

First, it removes the urgency to pay your card. You may think, "Oh, now I have a whole year to pay that off, I can take a few months off from paying my credit card bill." Suddenly, the debt is on a back burner and before you know it, you have only a few months left, and you're stuck with the choice of making huge payments to zero out the balance before the promotional period ends, or paying a much higher rate on the amount you still owe after the promo ends.

"We're all optimists when it comes to 'next year,'" says Thompson. "It's easy to tell ourselves, 'Next year will be better and some expense will end,' or, 'We'll have a windfall of some sort and we'll pay it off then.'"

Additionally, if you have a spending problem, seeing the $0 balance on your old card could tempt you to spend more on it, with promises to yourself to pay it off next payday, or that it's not as bad if you're only paying interest on a small charge rather than a huge balance.

"A balance transfer is part of [your] toolbox that we can use, but it's the disciplined approach and the planning that makes it successful," Chronowich says. In the end, if it sounds too good to be true, it's probably best to find a different solution, he says.

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