HOME LOAN OPTIMISER

HOW TO GET THE BEST OUT OF YOUR HOME LOAN

FINSURE
FINANCE AND INSURANCE

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CHOOSE THE RIGHT LOAN

Now that you've settled into your new home or completed the purchase of your investment property, it's time to manage your home loan so that you pay it down as soon as you can, without making unnecessary sacrifices.

Outlined in the following sections are a few different approaches you can take.

Cheapest rate for the features you need

The biggest single opportunity to reduce your mortgage is finding the cheapest interest rate you possibly can. If you're planning to make extra repayments, be sure your loan has the cheapest rate, with the flexibility to make extra payments that work in sync with your lifestyle. Home loans with these kinds of features might come at a slightly higher price, so you need to balance how much you need the flexibility with the overall cost of the loan. Only get the features you need as they do come at a price.

Be wary of introductory or honeymoon rate offers

Introductory or honeymoon rates have long been an important marketing tool for lenders. You are initially offered a cheap rate on your loan to get you in the door but once the honeymoon period is over, the lender will switch you to a higher variable interest rate.

There are two items to consider problems with this scenario. First, the variable rate is often higher than some of the lower basic loans available, so you could end up paying more. Second, you need to clearly understand that a honeymoon rate applies only for the first year or two of the loan and is a minor consideration compared to the actual variable rate that will determine your repayments over the next 25 to 30 years.

Home loan portability

If you are like most people, you won't live in the same house for the entire 25 or 30 years of your loan. With many home loans, you can now sell one home and buy another without having to reset the loan, thereby avoiding all the normal set-up and exit fees. There are however constants on the loan amount required on the new loan which may negate the benefit of this.

Match fixed rate

If it makes sense, make sure you match the fixed-rate period of your mortgage to the time that you may keep a property should you have an intent to sell in the near future e.g. do not take a fixed rate for ten years if you may sell the property in three years.

Use a loan with a 100% offset account

Mortgage offset accounts allow you to use your savings and income to reduce the amount of interest you pay on your mortgage, without actually locking away your money. An offset account is a separate bank account to your home loan or a loan split, but it is linked, from the same provider and opened at the same time. The balance in your offset account is 'offset' from your loan balance when calculating interest, your total loan amount. If example you have a $300,000 home loan, and you have $10,000 in your offset account interest is calculated on the balance i.e. $290,000 and so the money in your offset account saves you interest without you having to physically deposit it into your loan account.

Another benefit of using an offset account is the potential tax savings. As you don't actually receive any interest payments on your savings, because it is sitting in your home loan offset account, you don't need to pay tax on earning interest. You therefore get the full, tax-free benefit of the savings interest in reducing your home loan debt. This often operates best when your mortgage offset account is used as your primary bank account – for savings, lump sum payments and salary payments.

Mortgage offsets can be very effective if used correctly, but bear in mind that some lenders may charge additional monthly fees, for the privilege of this feature. It's important to do your sums, as it might not suit your circumstances, especially if you have a large mortgage and little savings to put in the offset account.

Direct salary credit

Your salary is an excellent example of a regular payment that should go directly into your home loan, even though you draw against it. It's a common feature amongst most home loans.

And since all of your income goes in to your home loan, it reduces your principal balance outstanding – as well as the interest it attracts.

You benefit because the lower interest bill allows you to pay off your home loan more quickly.

SEEK A MORTGAGE BROKER TO STAY INFORMED WITH COMPETITIVE PRODUCTS

Enlist the services of a professional mortgage broker who will keep you up to date with changes in the home loan market. You should also keep your mortgage broker up to date with changes in your personal finance situation too. You never know what opportunity might present itself with new products and changes in your circumstances. If you are informed, you can act.

Keep an eye on interest rates and, if they fall, consider refinancing. If you can reduce your interest rate, shorten the term of your loan or both, refinancing can be an excellent strategy. Outlined are some strategies that you can use with the help of your mortgage broker to pay off your home loan faster.

Look outside the big 4 banks

Big advertising budgets and size do not mean that the major banks always have the best products. If your mortgage broker suggests a lender you haven't heard much about, it doesn't mean they aren't reliable. Ultimately, it is your choice which you go with, but don't be afraid of smaller lenders and international banks as they could provide you big savings compared to the majors.

MAXIMISE THE EFFECT OF YOUR REPAYMENTS

By making a few simple changes to the timing of your repayments, or the odd extra repayment here and there, you can greatly reduce the amount of interest paid and the time to pay off your home loan.

Make your payments more often

As interest is usually calculated daily on the balance of your loan, making more frequent repayments reduces the compound interest on the loan.

One of the simplest and most effective strategies for reducing the term and cost of your loan (and thus your exposure should interest rates rise) is to make your repayment on a fortnightly rather than monthly basis.

Split your monthly payment in two and pay every fortnight. You'll hardly feel the difference in terms of your disposable income, but it could make thousands of dollars and years difference over the term of your loan. The reason for this is that there are 26 fortnights in a year, but only 12 months. Paying fortnightly means that you will be making the equivalent of 13 monthly payments every year, instead of 12. And this can make a big difference.

For example:
Loan Size: $250,000
Interest Rate 7%
Loan Term 30 Years

Using our example from above, by paying monthly, you will need to repay approximately $600,000 over the term of your loan. By paying fortnightly, you will save approximately $76,000 in interest and 6 years off the loan term.

Make payments greater than the minimum required

Make sure your loan gives you the ability to pay extra (regular or ad-hoc). Making additional payments on your loan, big or small, is a real benefit. If your interest is calculated daily, extra funds have the immediate effect of reducing the loan balance and, therefore, the interest payable. If the right loan is set up from the outset, making extra payments should be very easy via direct debit/credit, ATMs or internet and phone banking.

In addition to making more repayments than the minimum, a good strategy is to keep your repayments the same when interest rates go down.

Make extra repayments in the beginning

By making lump sum payments (from grants or personal savings) and keeping your regular repayments as high as possible early in the loan, you reduce the principal quickly, meaning you pay interest on a smaller amount later in the loan.

If you are in a position to choose when you make extra payments, make sure you pay extra in the beginning, as that is when you can achieve the greatest impact on your loan. The problem with any home loan is that, in the early stages, you are mostly paying interest and not reducing the principal all that much. Every dollar you can put against your loan early means a faster reduction of your principal and as a result, less interest payments down the track. A good example of this method would be to make your first mortgage repayment on the settlement date.

Pay your expenses on your credit card and maximise the benefit of the offset account

An offset account is typically available in a professional loan package which will also include the option of a credit card to the borrower(s) with no annual fees. When used appropriately in conjunction with an offset account, it can prove to be a great way to save on your loan repayments. Consider the following steps:

Have your salary and all your savings deposited into your offset account to maximise the full effect of the savings potential. This will bring an immediate effect as it will reduce your interest payable on the loan balance and with every pay you will decrease the amount of interest charged.

Pay for all your ongoing expenses such as groceries and bills using the credit card. Interest on the loan balance is usually calculated daily, this means that the longer the money stays in the offset account, the greater the savings you will get. Thus use your credit card on your monthly spending and then pay off the credit card just before the interest is charged to the account to maximise the savings.

Use cash only when you need to and be disciplined to avoid interest on the credit card.

Make an annual lump sum payment

Use your tax refund or a windfall such as an inheritance or work bonus, and apply it directly to your home loan. Check your mortgage documents to find out how often you can prepay and in what amount.

If your career advances over the years, it’s sensible to direct your raises and bonuses towards your loan. You were doing just fine without that money, so you shouldn’t miss it if you don’t get used to having it in your budget.

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