



Getting on top of your debt

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Things to consider
when borrowing to buy a home

Don't over-extend yourself



Research shows we tend to:



Be over-confident of our debt repayment ability



Underestimate likelihood of things going wrong

Source: Understanding human behaviour in financial decision making: Some insights from behavioural economics. Paper to accompany presentation to No Interest Loans Scheme Conference "Dignity in a Downturn" June 2009. Ian McAuley, Centre for Policy Development and University of Canberra

Causes of mortgage stress

RMIT
research



Looked at 'mortgage
stress' triggers



Did surveys and
interviews



Assessed 'initial' and
'final' causes of
missing repayments



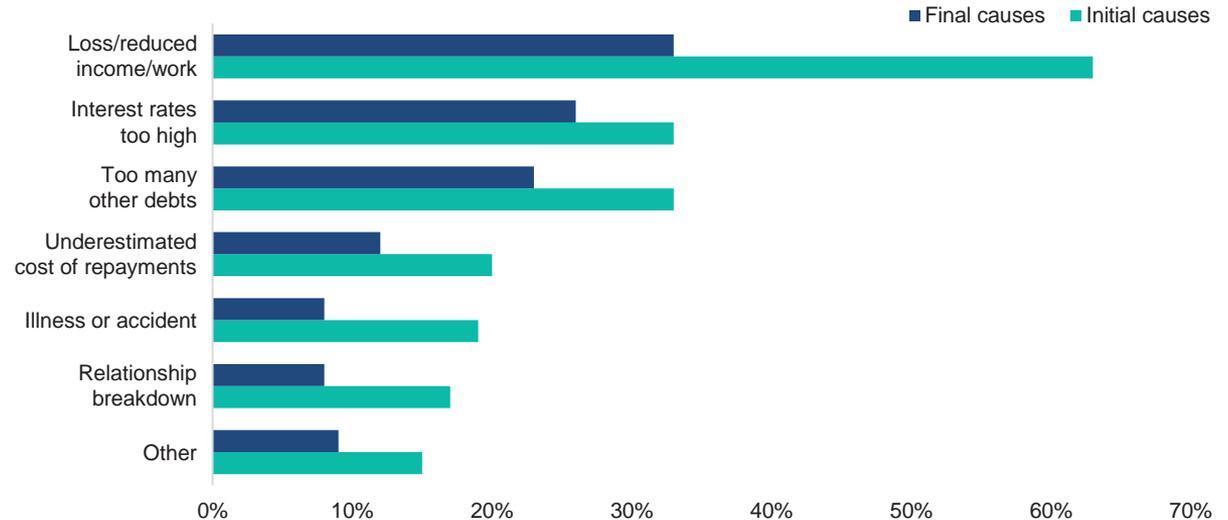
Typically more than
one reason

Source: Mortgage default in Australia: nature, causes and social and economic Impacts.

Authored by Mike Berry, Tony Dalton and Anitra Nelson for the Australian Housing and Urban Research Institute, RMIT Research Centre, March 2010

Causes of mortgage stress

Results



Source: Mortgage default in Australia: nature, causes and social and economic Impacts.

Authored by Mike Berry, Tony Dalton and Anitra Nelson for the Australian Housing and Urban Research Institute, RMIT Research Centre, March 2010

Common new borrower mistakes

Often don't understand:



Range of costs, such as:

- Mortgage insurance
- Stamp duty
- Solicitor/ conveyancer



Loan application process



Ownership options – 'joint tenants' vs 'tenants in common'



The rights and obligations where loan guarantees are provided



Mortgage vs offset account

A young woman with a colorful patterned scarf is smiling and looking down at a smartphone she is holding. The background is a bright, blurred office or public space with other people in the distance.

Ways to reduce personal debt

Ways to reduce personal debt



Smart strategies may include:



Consolidate debts



Use cash reserve
more effectively



Use cashflow more
effectively

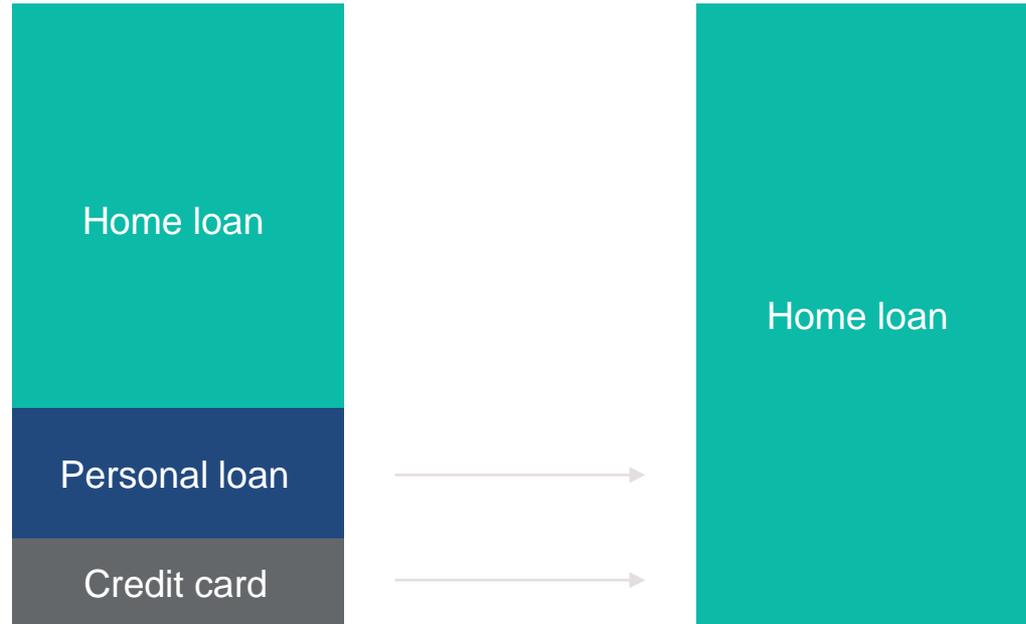
Debt consolidation

Why?

Personal loan and credit card interest rates are generally higher

By increasing your home loan and paying off these debts you could:

- Save on interest
- Pay off debts sooner



Debt consolidation

Debts	Outstanding balance	Interest rate	Current repayments (pm)
Home loan (20 year term)	\$400,000	7.5%	\$3,153
Personal loan (5 year term)	\$10,000	13%	\$223
Credit cards	\$5,000	19%	\$72
Total	\$415,000		\$3,448



Case study – background

Carolyn and Ian are married with young a family

Home worth \$600,000

Note: We have used a home loan interest rate of 7.5% as this is close to the historical average.

Debt consolidation

	Separate loans	Consolidated loan
Outstanding loan(s)	\$415,000	\$415,000
Monthly repayments	\$3,448	\$3,448
Remaining term	18 years 4 months	17 years 11 months
Total interest payments	\$341,596	\$323,682
Interest saving		\$17,914

Assumptions: In both options, we've assumed repayments of \$3,448 are made for the life of the home loan. With the separate loans, payments are redirected to the home loan once the personal loan is repaid.

Case study – strategy and outcomes

Increase home loan by \$15,000

Pay off personal loan and credit card

Make same total repayments of \$3,448 into home loan

Don't spend interest savings

Use emergency cash more effectively

	Cash account	Home loan / 100% offset account
Higher interest rate	No	Yes
Tax effective	No	Yes
Repay home loan sooner	No	Yes
Fast access to funds	Yes	Yes

How and why?

If hold emergency cash in home loan or offset account you could:

- Earn higher after-tax return
- Reduce loan term
- Still access funds

Use emergency cash more effectively



Case study – background

Carolyn and Ian own their home

Home loan \$400,000

Interest rate 7.5% p.a

Carolyn received \$12,000 bonus

Held in cash account earning 4% p.a

After-tax return only 2.44%¹ p.a

1. Assumed individual taxation of 39% (including Medicare levy).

Note: We have used a home loan interest rate of 7.5% as this is close to the historical average.

Use emergency cash more effectively

	Before strategy	After strategy
Loan balance on which interest calculated	\$400,000	\$388,000
Monthly home loan repayment	\$3,153	\$3,153
Time taken to repay the home loan	20 years	19 years
Total interest payments	\$355,988	319,277
Interest saving		\$36,711

Case study – strategy and outcomes

Transfers emergency cash into 100% offset account

Continues to repay \$3,153 per month

Use cashflow more effectively

How?

Strategy	How it could help repay debt faster
1. Increase repayment frequency	Reduces average daily loan balance even though annual repayments the same
2. Increase repayment amount	Reduces loan balance sooner
3. Salary crediting	Same as strategies 1 and 2, but greater effect as more money being applied against loan May achieve higher after-tax return than if salary paid into cash account Can access money to meet living expenses during month

Use cashflow more effectively

	Details	Combined (per annum)
After-tax salary (per fortnight)	Ian: \$2,700 Carolyn: \$1,800	\$117,000
Current living expenses (per month)	\$5,000	\$60,000
Current loan repayments (per month)	\$3,153	\$37,836
Surplus cashflow		\$19,164

Case study

Carolyn and Ian owe \$400,000
on their home loan

Use cashflow more effectively

Case study

Strategy	Annual repayments	Loan term	Total interest payments
Continue paying \$3,153 a month	\$37,836	20 years	\$355,988
Repay \$1,455 a fortnight	\$37,830	19 years 2 months	\$327,721
Increase fortnightly payments to \$1,475	\$38,350	18 years 8 months	\$317,021
Pay 100% of salary into loan ¹ Draw to pay living expenses ²	\$57,000	9 years 10 months	\$157,113

¹ \$4,500 per fortnight. ² \$5,000 per month

Thank you

