Discover 5 ways clever cash flow can save you thousands off your home loan

Clever cash flow

We have outlined 5 strategies to help you minimise interest and pay your home loan off faster. To understand how this works, you need to understand how interest is calculated on a mortgage.

Generally speaking, the interest on a home loan is calculated daily on the outstanding balance and added to the loan at the end of the monthly cycle. By paying extra on your loan you reduce the balance, and every day you leave additional payments on your loan the interest is calculated on a lower balance. For example:

A loan of $100,000 at a rate of 7% per annum would incur interest of $7,000 per annum.

Divide $7,000 by 365 days to get the daily interest.

Daily interest = $100,000 x 7% / 365 = $19.18 per day.

1. Repay your mortgage fortnightly

Make repayments on your mortgage fortnightly as opposed to monthly. This will accelerate your repayments by an additional month each year.

A monthly repayment is based on there being 12 months in a year and 4 weeks per month, equating to 48 weeks. As there are 26 fortnights in a year, paying fortnightly will see you repay an additional monthly repayment every year. The trick is to divide your monthly repayment by two and pay this amount on a fortnightly basis.

For example:

A monthly repayment of $2,000 over 12 months would equate to $24,000 in repayments.

However if we divide this figure in half ($1,000) and make 26 repayments this would equate to $26,000 - an additional $2,000 paid per annum.

Also, as you are repaying the loan more frequently, the daily balance is lower for half the month and therefore the interest is calculated on this lesser balance each fortnight.

2. Have your regular pay credited directly into your home loan or offset account

By arranging for your regular salary to be paid directly into your home loan or offset account, you will maximise the reduction of your loan balance with all available funds and subsequently reduce your interest bill.

3. Use your mortgage as your savings account

Don't save your money in a separate bank account where you will likely earn a lower rate of interest than your mortgage interest rate. Any interest earned on a savings account will be subject to income tax. Whereas the interest you are saving on your home loan is not income, so will therefore give a better return.

For example:

Let's assume a borrower has a marginal tax rate of 40% (excluding Medicare levy) and $10,000 spare cash.

If she put this money in a savings account paying 5% interest pa, she would get a return of roughly $50. After tax of 40% she would have $30 remaining.

If she put this money into her mortgage with a rate of 7% per annum, the saving would be $70. As there is no tax on savings she would have $70 remaining.

4. Pay your bills using a credit card with an interest free period

Whether your bills are one-off expenses or regular commitments think about paying them on a credit card with an interest free period, and where possible set up direct debts to ensure bills are paid without hassle.

Deposit your regular income into your home loan or offset account. At the end of each month or just before your next mortgage repayment, redraw the necessary funds to pay off the credit card balance in full. This will maximise your ability to reduce your loan balance for as long as possible, saving you maximum interest.

The idea is not to pay interest on the credit card and at

the same time, leave your money parked in your home loan for as long as possible each month, to reduce the interest expense as much as possible.

Be careful not to spend more money on your credit card than you have available to pay off each month, or you may find yourself going backwards – discipline is essential. A good rule is – if you wouldn't pay for it with cash, don't put it on the credit card.

5. Consider fixing a portion of your home loan when rates are cyclically low.

By locking in a large portion of your home loan on a low rate, you could dramatically reduce your total interest costs. You should leave a portion of your loan variable as many lenders will have restrictions on the extra repayments available on a fixed rate mortgage, so any surplus funds you have may not be able to be repaid on the home loan.

By leaving a smaller portion as variable, you can concentrate on reducing this balance with extra repayments, whilst maintaining low interest costs due to the low fixed rate on the other component.

Note that fixed rates should be treated with caution as lenders will generally charge break costs if you want to repay this loan early. Break costs can be very expensive depending on the circumstances. This can happen if a borrower refinances their mortgage to another loan, or sells the property resulting in the loan being paid out in full. It is crucial to seek advice before making a decision on fixed rate loans as mistakes can be costly.

FOR FURTHER INFORMATION PLEASE CONTACT

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