

# How to have a better relationship with debt



## Life after debt

When used in a disciplined way debt is a valuable wealth creation tool, but you need to understand how it works to ensure you make the most of the opportunities available to you. Building a sound understanding of the following concepts will set you up for success.

### 1. Change your thinking

Your home loan has helped you to buy your property. Without it you would likely never have been able to save enough money to buy it outright.

If you simply pay the minimum repayments on a principal and interest loan you will pay it off at the end of the term – usually 30 years. If you make extra repayments you will inevitably pay your home loan off sooner and even small but regular amounts have a significant effect over time.

#### For example:

Paying as little as \$20 extra a week on a home loan of \$300,000 with an interest rate of 8% will save 4 years of the 30 year term and over \$79,000 in interest expenses.

You don't need to pay every spare cent on your home loan to the point where you can't meet your living expenses comfortably, but by maintaining a disciplined approach and consciously repaying more than the minimum required the savings will add up over time.

### 2. Set a budget and track your spending

Clever planning can make all the difference. If you don't know what you are spending your money on during the year, how can you possibly get ahead? It pays to set aside half an hour to sit down and work out where your money goes and where you can make savings.

Be realistic about what your expenses are and don't forget to include one-off expenses like Christmas shopping, birthdays and holidays.

Work out how much you have left over every pay cycle and what you are going to do with this extra money. How effectively you use your surplus cash flow to reduce debt and create wealth will be a major determinant of your long-term success.



### 3. Set goals

After you have determined how much money you have left over each week, workout how much extra you want to repay on your home loan and get started.

If you are using an offset account, be careful not to spend all your money each pay. You could even contact your lender and ask them to increase your existing repayments by the extra amount each period.

You will need to be mindful that if interest rates increase, so will your minimum repayment and this will eat into your extra repayments so keep an eye on your loan if rates move.

### 4. Understand the numbers

Interest is calculated daily on the balance of your loan. Some people think that as the loan reduces, so do the repayments, yet this is not true for many loans. Your repayments will stay the same unless interest rates change. The portion of interest reduces as the loan balance reduces but the repayments will stay the same. This means that the portion of principal being repaid will increase.

#### For example:

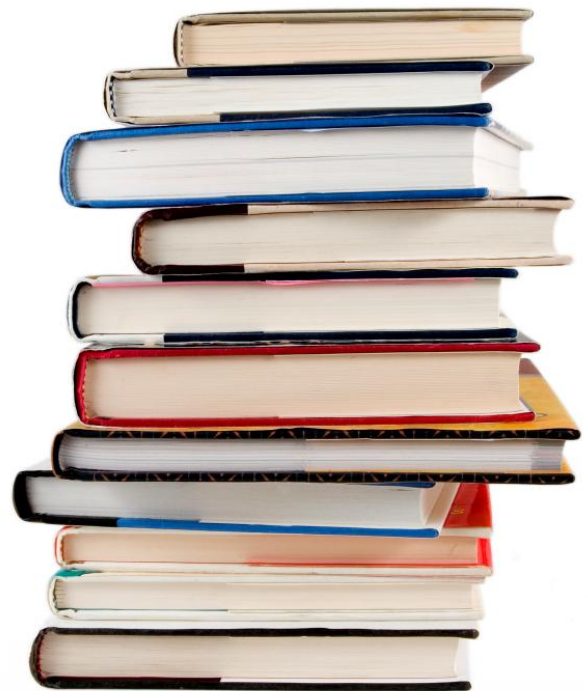
Principal and Interest repayments on a 30-year loan at an interest rate of 8% would be \$2,201 per month with a total initial interest component of \$2,000. This means that \$201 per month is initially repaid of the principal amount. In 15 years time (assuming the interest rate is still 8%) the repayments would still be \$2,201 per month - however the interest component is now \$1,536. This means that \$664 per month is being repaid of the principal amount.

The key concept to remember is that every day your loan balance is reduced or offset, you are reducing the interest being charged, and therefore the life of the loan.

### 5. Have a contingency plan

What happens if you don't have income for a period of time to make your repayments? Some lenders will allow you to put a halt on your repayments for a short period if you are unable to make them. You will need to catch up on these repayments later and this could result in higher interest charges due to the missed repayments.

Rather than be forced into this situation, have a contingency plan. Keep some money aside to make repayments whilst you don't have income. If you have been making extra repayments for some time, you may have accumulated enough to get you through. It may also be worth talking to a financial planner to look at what type of insurances you should consider.



**FOR FURTHER INFORMATION  
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