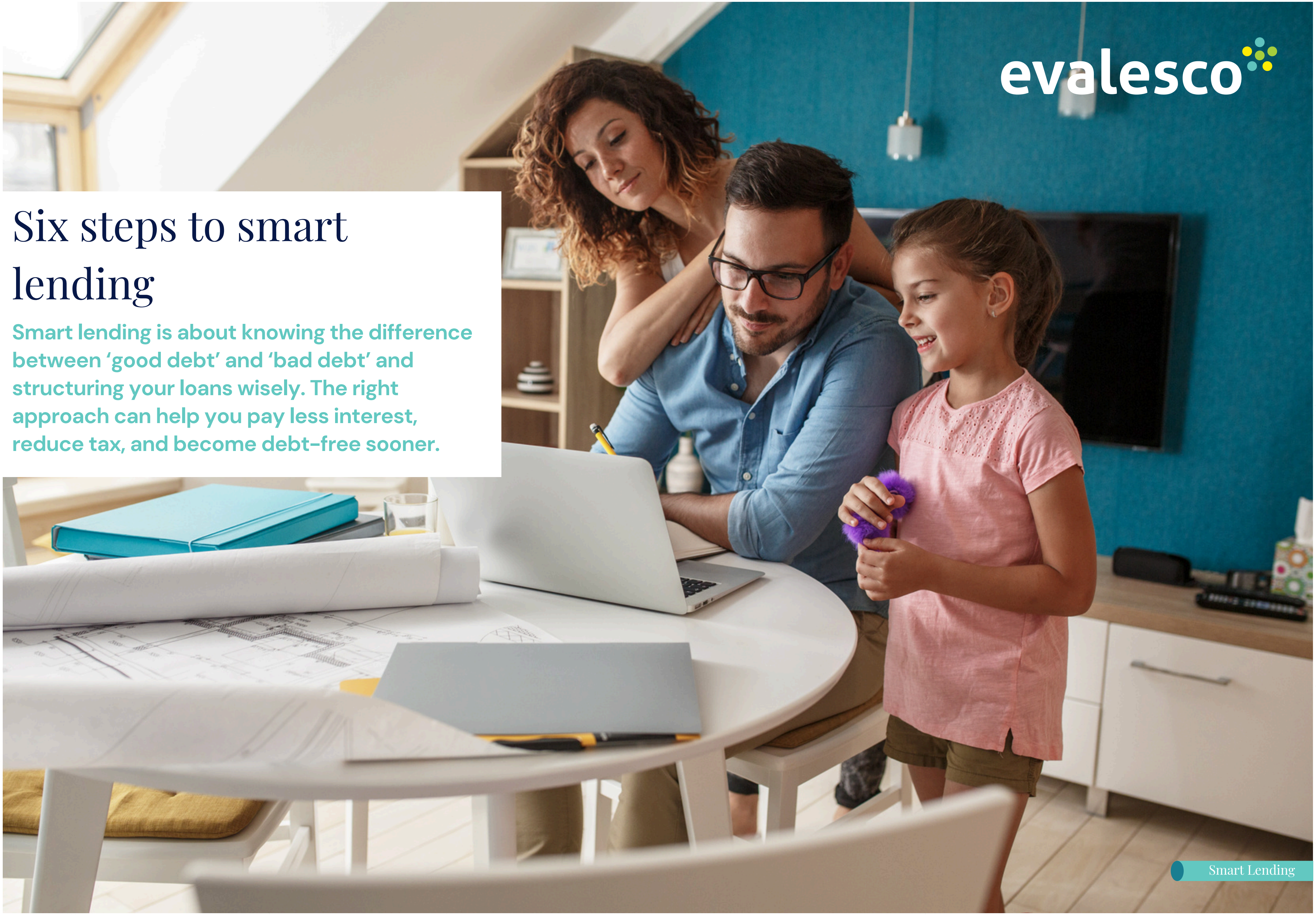


evalesco

Six steps to smart lending

Smart lending is about knowing the difference between 'good debt' and 'bad debt' and structuring your loans wisely. The right approach can help you pay less interest, reduce tax, and become debt-free sooner.

Good Debt

'Good debt' covers borrowing that is used exclusively for the purpose of acquiring assets that generate an income (and ideally offer additional returns by way of capital growth).

When you borrow money for an investment property or a share portfolio, generally this is considered good debt because the interest you pay may be a claimable expense against your other income enabling you to reduce your tax payable.

Therefore the cost of that debt is generally lower (depending on your tax rate) because you are getting a tax deduction – hence good debt is also often referred to as 'deductible' debt.

This type of borrowing enables you to acquire growth assets faster, with the aim of improving your overall wealth position. .

Bad Debt

'Bad debt' is best described as lifestyle debt, such as credit cards, store cards and personal loans. It's any debt that you can't claim a deduction on – hence why it's also referred to as 'non-deductible' debt.

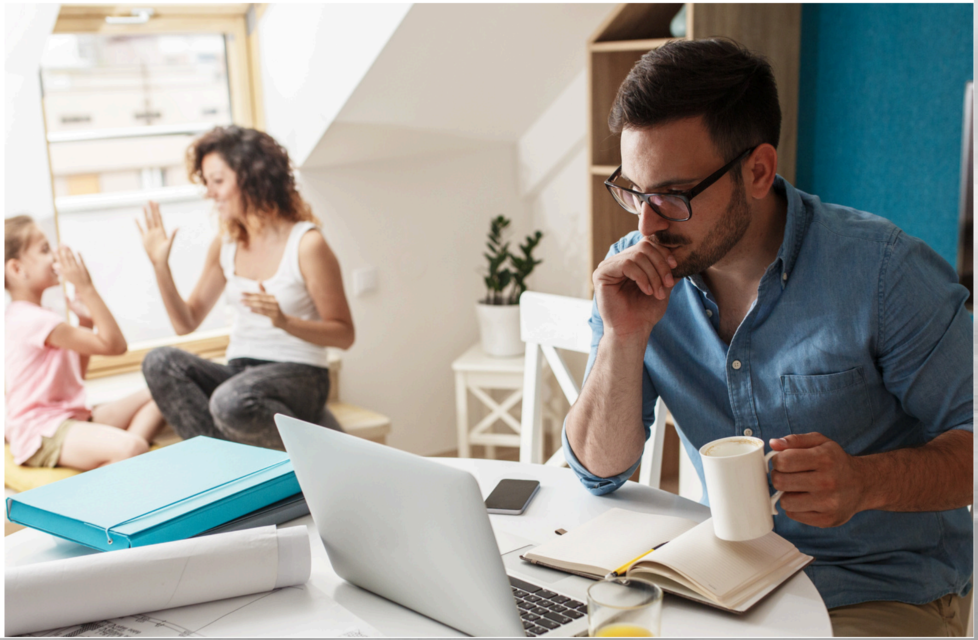
We also consider your home loan as bad debt – even though it's used to acquire a property asset, which should grow in value over the long term (unlike cars, boats or other lifestyle assets), you can't claim a tax deduction on the interest.

Therefore it's a more expensive debt in real terms, and one that you'll want to get rid of as quickly as possible.

Smart ways to structure your lending

So now knowing the difference between 'good debt' and 'bad debt' it is important to structure your debts in order to improve your financial health. Here we look at a number of strategies that can help you achieve this.

1. Pay off your bad debt first
2. Home loan and investment loan repayments
3. Fixed and variable loans
4. Change the way you save
5. Consider fixing your investment loan
6. Have your loans reviewed annually



A guide to debt recycling strategies

Debt recycling can be a powerful strategy designed to swiftly pay down non-deductible debt and transform it into tax-deductible debt, potentially propelling your wealth creation journey.

A closer look at how it works

Debt recycling involves drawing equity from your home to invest in income-producing assets such as shares or investment property.

For example, you are paying your home loan when you have $500,000 that you have built up in equity. You can then draw out some of this equity and invest it into the property market or shares.

The interest that is applied on the new investment loan to purchase the investment property may be tax-deductible. In which case you may be able to use the tax savings and investment income to pay down your family home loan more quickly.

You have created multiple assets, one of which produces income that helps to pay for the costs of the other.

If your new investments go up in value, you will be building your wealth at the same time.

At the end of the first year, you could increase your investment loan by the same amount that you have paid off your home loan. Reinvest this increased amount systematically each year, aiming to eventually replace your home loan entirely with the investment loan.

Navigating the risks: Five things to consider

Our team have come up with five points to consider, before delving into this approach, as this is not a strategy that is ideal for everyone.

1. During favourable market conditions, leveraging borrowed funds for investment can amplify profits. Conversely, in a declining market, the losses incurred are magnified due to the ongoing obligation of interest payments and loan repayment.
2. If the interest rate on your loan is variable, a surge in interest rates may result in higher repayments. This could strain your cash flow, particularly if your investment income falls below expectations. A secure income is crucial for comfortably servicing both loans and maximising tax advantages. It is recommended for those with a stable income.
3. Assets acquired through borrowed capital are susceptible to depreciation. Despite potential tax deductions over time, the value of the investment can still decline, leaving you with debt even upon selling the asset.
4. Exercising restraint and financial discipline is crucial when redirecting investment income and tax savings towards your home loan. Resisting the temptation to spend these funds on non-essential items like vacations or new vehicles requires a dedicated commitment.
5. Should you opt for this strategy, it is advisable to reassess your insurance coverage to ensure that any additional loan can be settled in the event of unforeseen circumstances, such as death or incapacity, affecting you.

Pay off your bad debt first

Aim to pay off your non-deductible debts such as credit cards, personal loans and home loans first. Start with the ones that are attracting the highest interest rates.

There is no point focusing on paying off your home loan with an interest rate of 2.7% when you have outstanding credit card debt that you are paying 19% interest on.

Home loan and investment loan repayments

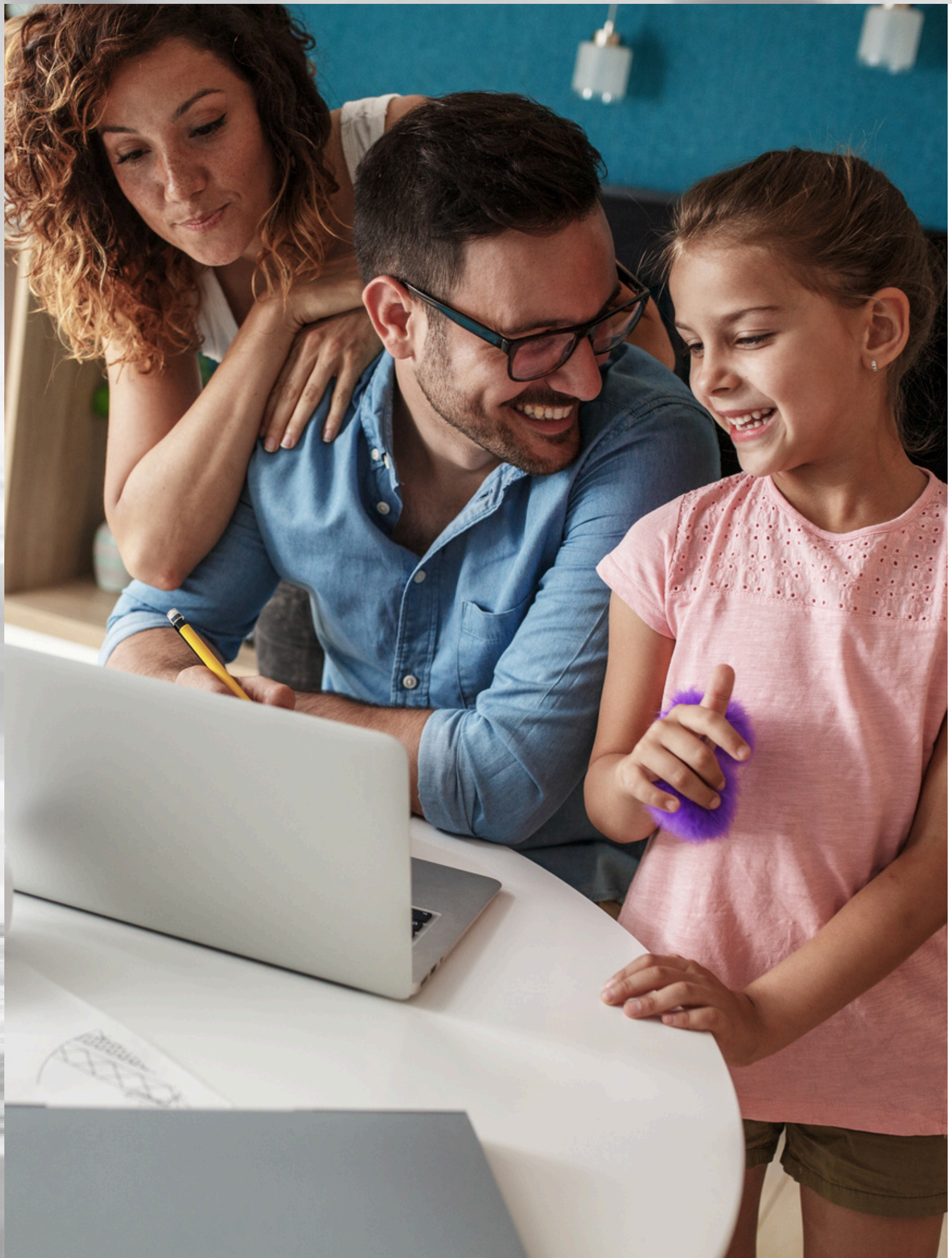
Where possible, set up your home loan with principal and interest repayments and your investment loan with interest only repayments. Use any surplus cash to pay into your home loan first.

The reason for this is that you want more of your money paying down your non-deductible home loan than your deductible investment loan.

Fixed and variable loans

You may also want to look at splitting your home loan into fixed and variable components. Fixing a portion of your loan gives you greater certainty and ease of budgeting for your repayments. And, the variable component allows you to pay extra repayments to reduce the loan size.

Having the variable component is important due to the limitations of fixed rate loans, such as a limited ability to make additional repayments, usually around $10,000 per annum and generally not being able to link a 100% offset account to your loan.



Healthy Wealthy Happy

Change the way you save

Traditionally people use savings accounts as a home for their money especially when saving for goals.

However, there is a better way: use an offset account linked to your home loan for savings rather than an interest-bearing savings account.

The reason for this is rather than earning interest at say, 4.20% (the after-tax rate is even lower given that you'll pay tax on the interest income), you're better to save interest at 6.09% on your home loan.

Some lenders allow you to link up to ten offset accounts to your variable home loan under the one package, so you can set aside funds for different savings goals.

For example a holiday, a new car or renovations. The total sum of your offset account balances reduces the home loan balance on which interest is calculated – effectively helping you to pay off your home loan sooner while saving for your goals!

Case Study

John and Sarah have been long-term clients on Evaelsco, where we managed their super/investments and financial plan for many years. We have also helped them achieve their goals in purchasing an investment property. As part of their annual review, we reviewed their loans and noticed they were on a high interest rate compared to the current market. We did put in a pricing request with their current lender, however, they refused to provide the client with any further discounts as they believed they were in the best interest they could offer.

There were some complexities to their circumstances, with self-employed income and the investment property receiving Airbnb income rather than rental income, which the majority of lenders will either not include in serviceability or shave down significantly. Their investment loan had also an Interest-only term that had recently switched to P&I repayments and they were hoping to extend this loan with IO repayments for a further 5 years, so they could focus on paying down their non-deductable home loan as a priority. After some research, we found a lender that was able to use 100% of the Airbnb income and was able to use one-year financials for the self-employed income instead of averaging the last two years, which all helped with their serviceability. We were also able to extend the interest-only term for their investment loan, which will allow them to direct more funds to their non-deducible home loan and allow them to pay this off sooner and reach their goal of having their home loan paid out as soon as possible.

Current interest rates:

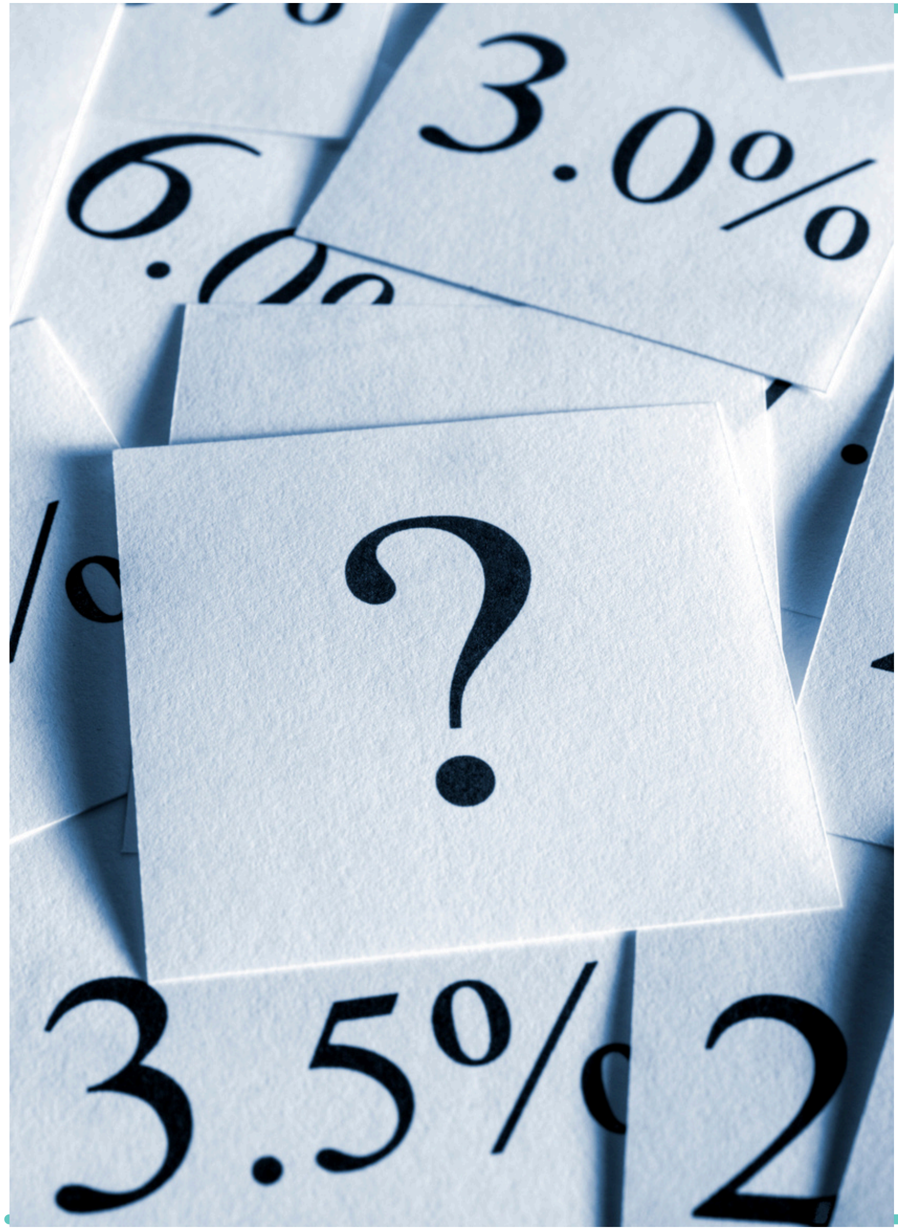
Investment Interest rate with P&I repayments 7.19%
Investment interest rate with IO repayments 9.14%
Home Loan interest rate with P&I repayments 6.74%

New summary after refinancing:

Investment Interest rate with P&I repayments: 6.34%
Investment Loan with IO repayments: 6.64%
Home loan interest rate with P&I repayments 6.24%

This saves the clients $8,282 pa in the first year (after factoring in refinancing costs) and $10,207 thereafter.

The total savings over the life of the loan will be $304,285.



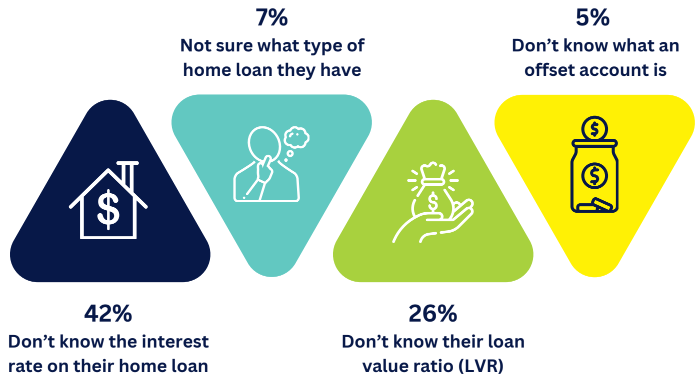
Do you know your current interest rate?

2 in 5 don't know their interest rate

While 75% of Aussie mortgage holders were openly concerned about their repayments according to Mozo's research from March, 2024, representing 2,554 Australians aged 18 years and over, many were unaware of critical features that could save them money over time.

- 2 in 5 (42%) of mortgage holders admitted they didn't know their home loan interest rate, but this is the key feature in determining the cost of your home loan.
- 1 in 5 (20%) hadn't compared their interest rate to others on the market since taking out their home loan.

This lack of awareness signals a huge opportunity for Aussies to improve their home loan literacy and save hundreds of thousands of dollars over the life of the loan.



Have your loans reviewed annually

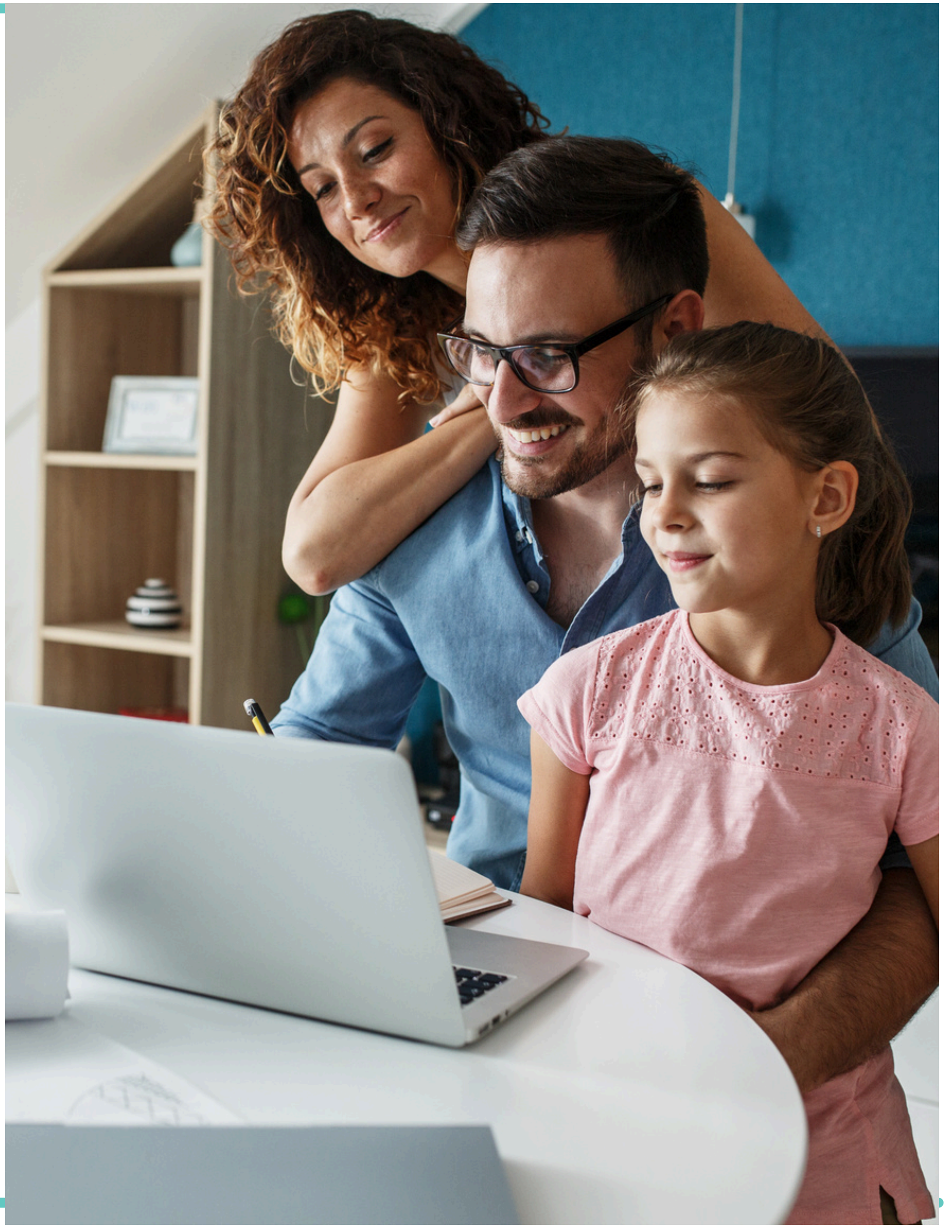
It is important to have your loans reviewed annually. The lending market is highly competitive and you'll often get a better rate if you are willing to refinance.

The cost of moving lenders is often less than you think and some lenders offer refinance rebates that may result in you being in front as a result of switching.

It's important to bear in mind when comparing rates that investment property loans are usually around 0.25% higher than owner occupied home loans, based on principal and interest repayments.

Many lenders will give their best rate for owner occupied loans paying principal and interest repayments. Some lenders won't even allow interest only loans for owner occupied purposes, whilst others will charge a higher rate.

It's important that your loan structure aims to take advantage of not only the best possible rate, but also offers features that maximise your ability to pay off your non-deductible debt as soon as possible.



Have your loans reviewed annually. Let us help.

Our licenced mortgage brokers are experts in lending advice, and will help you weigh up your options and answer any questions you may have.

They will assist you in securing the best home loan rate and structuring your loans in the best possible way for your unique situation.

Get in touch with us now for your free home loan health check.

Kristi Teasel
Mortgage Broker

Navigating the lending landscape can be complex, but the right guidance makes all the difference.

Our mortgage broking specialists at Evalesco Financial Services are here to help you make informed decisions, secure competitive loan options, and structure your borrowing wisely.

Let us help you make smarter lending decisions that set you up for long-term success.

To arrange an obligation-free consultation with an Evalesco Adviser, call (02) 9232 6880 or email admin@evalesco.com.au.

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