



# Clever ways to get rid of your mortgage fast

If you're looking for simple yet effective ways to pay off your mortgage, read on as **Ashley Ormond** shares a few tips from his book *101 Ways to Get Out of Debt and on the Road to Wealth*

## Don't keep switching loans

When refinancing, it is important to focus on the long-term savings and avoid the temptation to constantly chase the lowest short-term rates in the market. If you repeatedly switch from loan to loan, chasing the best rate each year, the costs of financing tend to outweigh any savings. You also need to factor in all your time and effort, and all the headaches and hassles involved in constantly shopping around and switching.

Refinancing your mortgage is not without costs. Many lenders charge 'penalty interest' for early repayments. Often the penalties are higher if the loan is repaid in the first year or so of the mortgage. This is one of the key factors you should always find out about when taking out a mortgage.

The new lender usually wants to charge an application fee (maybe \$500), plus a couple of hundred dollars for legal fees and a valuation. In most states there is also mortgage stamp duty of several hundred dollars per \$100 000 borrowed. If you are refinancing with the same lender there will be no stamp duty (unless you are increasing the loan amount) and it

should also not charge fees for application, legal or valuation.

If you are refinancing with a new lender you will not be able to avoid the mortgage stamp duty, so make sure the savings in interest more than outweigh the extra cost. For example, mortgage stamp duty of 0.4% on a \$300 000 loan is \$1200, plus other upfront fees of, say, \$500 make the total \$1700. If you are reducing the interest rate by 0.5%, that's a saving of \$1500 in interest each year. So the stamp duty is paid by the lower interest rate in a little over one year.

Try to get the new lender to reduce or waive any upfront fees. Generally the larger the loan and the more business you can offer the lender (such as investment property loans or investment accounts), the more bargaining power you have. If you ask for a discount and make it look like you are expecting to get one, nine times out of 10 it will work.

One of the big problems with shopping around to chase the lowest rate is that mortgage rates change every few months, along with the changes in the money market. Each time rates change, not all lenders change their rates by the same

amount. This means that a lender with the lowest rates one year will often not have the lowest rates next year. To always have the lowest rate you would need to switch lenders every few months or every year, and that will never be cost-effective.

If you have a plan to pay off the mortgage in, say, five years, focus your refinancing effort on finding a loan that has consistently been among the lowest rates over several years (but not necessarily the absolute lowest rate) instead of constantly switching from loan to loan. Then put all your efforts into paying off and getting rid of the mortgage forever.

## Always choose principal-and-interest loans over interest-only loans

Most home mortgages in Australia are principal-and-interest (P&I), which means that a portion of each repayment goes towards paying the principal balance so, by the end of the loan term, the balance is paid off completely. We have already seen with P&I loans how lengthening the term of the loan adds substantially to the total interest bill and slows the rate at which the loan balance reduces, so you stay in more debt for longer.

Interest-only loans are the ultimate in long-term loans. Unless you sell the house or switch into a P&I loan, you'll never get rid of the mortgage and you'll be paying interest forever.

Repayments on interest-only loans are lower than P&I loans because you're not

repaying any principal off the balance. This sounds attractive in theory, but in practice this is generally not a good thing because it just encourages lenders to lend you more money and encourages borrowers to borrow more than they otherwise would.

Let's get back to basics. A home bought with borrowed money is not an investment, it is a savings plan. It is not an investment because even well-located residential property grows in value by only about 2–3% above the inflation rate over the long term, and the interest rates on housing loans are also around 2–3% above the inflation rate. So you don't build any real equity in your home unless you pay off the loan. A P&I mortgage is a good savings plan because it forces you to pay back part of the principal each month, so you build real equity over time. An interest-only loan is only a partial savings plan because you are only forced to cover the interest on the loan, but never actually pay off the loan itself.

If you currently have an interest-only mortgage on your home and want to get out of debt one day, you need to either sell and trade down to a cheaper home or get into a P&I mortgage.

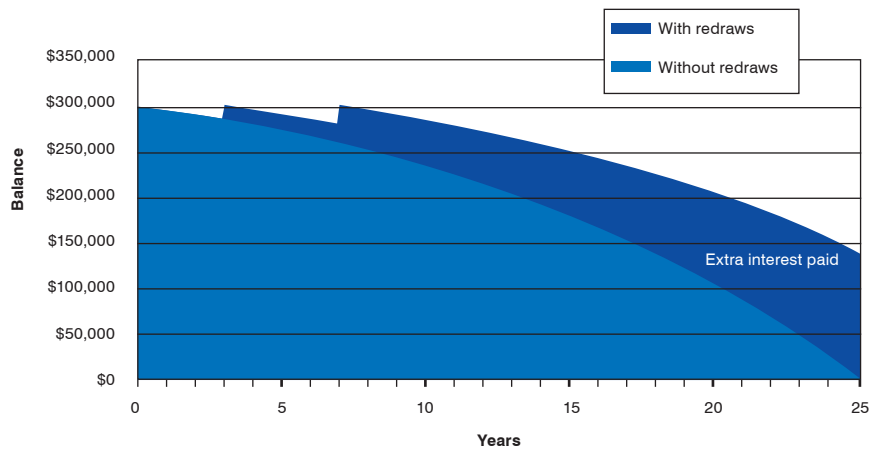
Assuming you want to stay in your home, that means shifting from interest-only to P&I. Think back to when you took out the loan initially. Your income has probably risen since then, but for most people, extra income somehow just disappears in higher spending. You need to find where that extra money is going and start putting some of it towards paying off the principal with a P&I loan.

If you have a loan of \$300 000 at 7%, the interest-only repayments are \$1750 per month. Switching into a 25-year P&I loan at the same interest rate means repayments jump by 21% to \$2120 per month. Switching to a 30-year P&I loan means repayments jump by 14% to \$1996 per month. This is a jump of \$246 per month, or \$8 per day. Start thinking where that \$8 per day is currently going and make a plan to put it into the mortgage instead.

### Avoid redraw mortgages

The redraw mortgage was another 'innovation' of the 1990s that sounded great initially, but it was really just another trick lenders used to keep borrowers in debt for longer. These days just about every lender offers redraw options on their mortgages, always at

### Extra interest paid if the redraw mortgage is used



Redraw 1: \$15 000 at end of year 3  
 Redraw 2: \$20 000 at end of year 7  
 Balance at end of 25 years: \$139 907

Loan amount: \$300 000  
 Interest rate: 7.0%  
 Regular term: 25 years

Regular payments: \$2120.34  
 Total interest paid: \$336 101

a higher interest rate than their basic no-frills mortgage.

A mortgage with a redraw facility allows the borrower to redraw the principal they have paid off the balance. For example, if you started out with a \$300,000 mortgage over 25 years at 7%, after five years the balance will have reduced to \$273,486, so \$26,514 has come off the principal. A redraw facility allows the borrower to re-borrow this \$26,514 so the mortgage goes back to the original \$300,000. Paying off the mortgage once is hard enough. Why would you want to repay money you've already repaid once?

In the first five years of the loan, the borrower would have paid a massive \$127,220 in total payments to the lender, but just 21% of the payments reduce the balance. Nearly 80% of the repayments pay interest to the lender. Reducing the balance is tough! Why would you want to start out all over again by redrawing it back to the original amount?

Don't be tempted to redraw money from the mortgage to pay for living expenses or depreciating assets such as cars, boats, furniture, holidays and renovations. The rule of thumb is if you can't pay cash for living expenses and depreciating items, then you can't afford them.

As an example of how bad redraw mortgages are, let's say you start out with a \$300,000 mortgage at 7% for 25 years. You redraw \$15,000 at the end

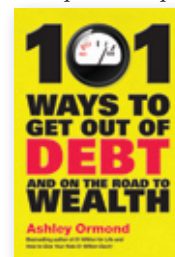
of year three to buy a car, and another \$20,000 at the end of year seven to buy a boat, and keep making the same regular repayments. If you didn't redraw you would end up paying off the mortgage fully at the end of the 25-year term. But by making the two redraws you would still owe \$139,000 at the end of 25 years!

Unless you sold the house to clear the debt, you would need to refinance this balance and, if you kept the same repayments and same interest rate, it would keep you in debt for another seven years (see graph above).

The \$15,000 car and \$20,000 boat end up costing you a massive \$139,000, and they keep you in debt for seven years longer! Just don't do it!

If you have a redraw facility on your mortgage, the best thing to do with it is to never use it. But the problem is that you're still paying for it every day in the form of higher interest rates charged on redraws loans. It is better to switch to a basic no-frills loan at a lower interest rate that doesn't include redraws. **YM**

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