2018

In the past two years, **banks have virtually stopped giving investors "interest-only" loans** on Australian property, and have been insisting on buyers making regular principle repayments. This has led many investors to become confused, and unsure whether an investment property still makes sense with this type of repayment.

THIS SPECIAL REPORT EXAMINES:

1. Interest-only vs. principle repayment loans: **positives and negatives.**

2. How to pay **3.73%** interest on a **6%** interest rate loan.

3. When is a repayment loan **MUCH** better than an interest-only loan.

4. When should you **ONLY** take an interest-only loan.

INTRODUCTION

The Australian banks have recently cracked down on interest-only loans, and many investors feel deprived! However, some simple examination of the facts reveals some very interesting information.

In the last 7 to 10 years there has been a huge trend by investors to move away from repaying capital and only paying the interest on a loan.

The idea behind interest-only loans is quite simple:

They say that:

1. **The interest is fully tax deductible so you want to maximise your interest payments and get the highest possible tax benefits.**
2. **It is better for cash flow.**

Let's explore briefly those two comments.

FIRSTLY LET'S LOOK AT CASH FLOW

In simple terms if you have a **6% interest-only loan on a $322,000 dollar mortgage** which was used to buy a property for $460,000 the interest figure **per annum is $19,320**. (322,000 x 6%) Could not be simpler.

In monthly terms it is $1,610 per month.

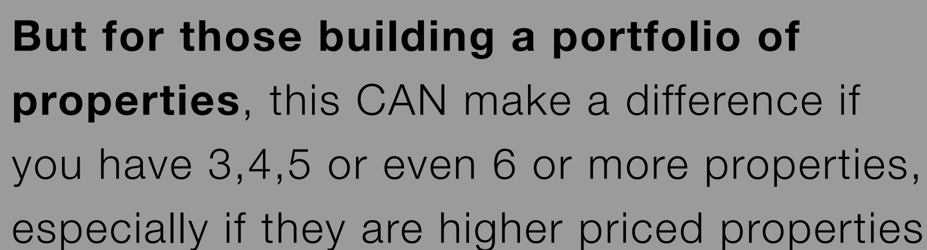
With **rent of 5% return** (such as available in Brisbane. Melbourne and Sydney will be a bit less) you are getting **$23,000 per annum** (or $1,917 per month).

So you can clearly see that the rent is covering the whole of the bank interest, with a bit of surplus to help with other expenses.

But if you take a principal and interest loan over (say) **25 years the total bank repayment is $24,896 per annum** (or $2,074 at the same interest rate of 6%)

So clearly you are paying $464 dollars more per month on the principal and interest loan.

Not a huge amount, about 15 bucks a day, so it is unlikely to be a deal killer for most people.



But for those building a portfolio of properties, this CAN make a difference if you have 3,4,5 or even 6 or more properties, especially if they are higher priced properties

But for **most people**, who have just one or possibly two properties, or those just starting their portfolio, it is crucial to understand the following.

THERE ARE 3 CRITICAL PIECES OF INFORMATION YOU SHOULD KNOW.

The first is this

“A fixed-rate mortgage amortizes over the loan’s repayment period, meaning the proportion of interest paid vs. principal repaid changes each month while the total monthly payment stays the same. As the loan amortizes, the **amount of monthly interest paid decreases** while the amount of principal paid increases”

The second is this.

Making principle payments greatly reduces the total interest you pay.

MEANING in fact **your 6% interest rate is actually just 3.73%!** (See below)

All for $15 a day!

FULLY MAXIMISE YOUR TAX CREDITS IS THE OTHER POINT MENTIONED

Strictly speaking this is true. But did you know that when you take a principal and interest loan actually you are paying mostly interest in the early years? **Most people are just simply not aware of this.** So in many ways it is just like an interest-only loan!

YEAR ONE:

interest-only: **$1,610** per month

P and I loan: interest **$1,597** per month

Just $13 a month for tax credits. At 32.5% tax rate that means you are getting just $4.22 per month extra benefit.

YEAR TWO:

interest-only: **$1,610** per month

P and I loan: interest **$1,567** per month!

Investment loan interest and payments over 25 years

So you're still getting nearly all the same tax credits available so that argument doesn't apply at least not in the early years.

<But here is a critical point to consider: that extra money you are paying can effectively be called "savings" because you are using that to every month reduce the amount of your debt to the bank, which then also reduces the total interest you pay>

NOW THIS IS IMPORTANT:

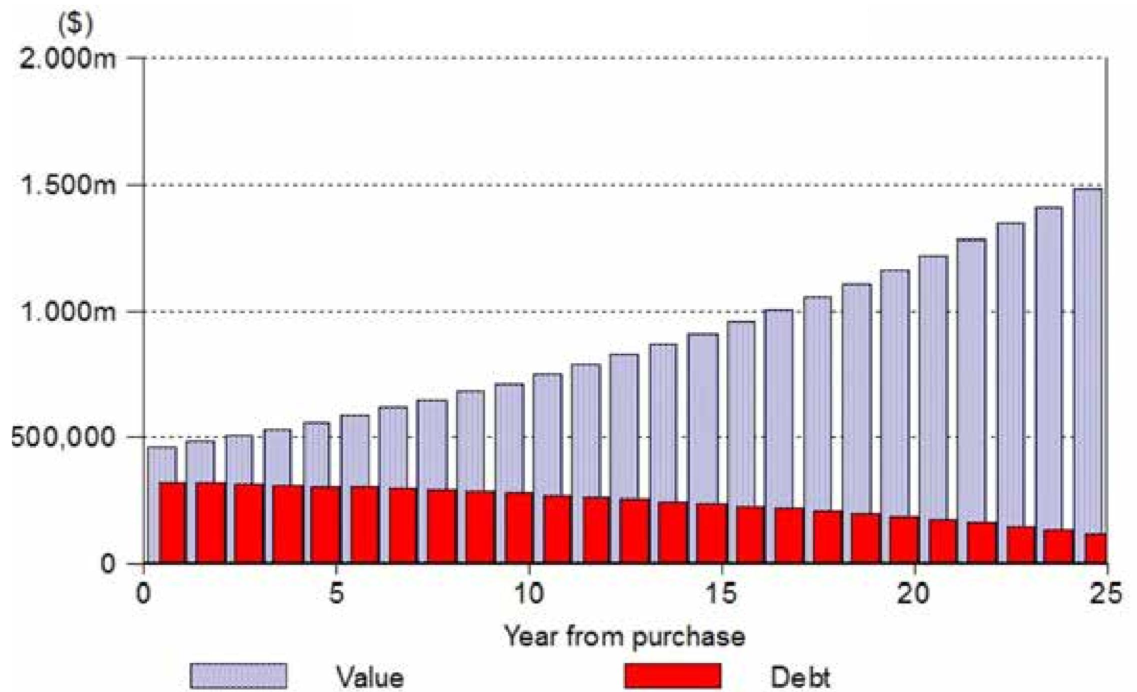
Let's compare how much interest you will pay.

If paying interest-only you pay over 25 years a total $483,000 in interest.

At 5% appreciation in the property value you sell for $1.567 million.

Hard to believe but it usually happens.

Repay the loan of $322,000 and Voila! You have $1.245 million left.



Property value & debt projections over 25 years

On the principle and interest loan you have repaid the whole principle so you are left with the full $1.567million in your hand.

AND…

You paid a TOTAL of only $300,396 in interest.

A cash saving of $183,000 in interest!

If interest-only it would have been an effective rate of paying 3.73% pa.
($300,396/25 years=$12,016 pa /322,000= 3.73%)

CONCLUSION

Principle loans are also an excellent way for most to purchase property, you get the most tax benefits when you need them in the early years, you are reducing the debt steadily, getting equity build up, and you save a massive amount of interest over the long term, **potentially** lowering significantly your interest rate.

They are NOT so good when:

1. **You are buying a number of properties**, unless you can manage the cash flow.

2. **You are buying higher price properties**, unless you can manage the cash flow.

3. **You are over 55 years old**, as most banks have an age limit around 75 years, as you will usually want to get a 20 year loan, unless you can manage the cash flow.

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