Debt strategies

Consolidate debts to save money

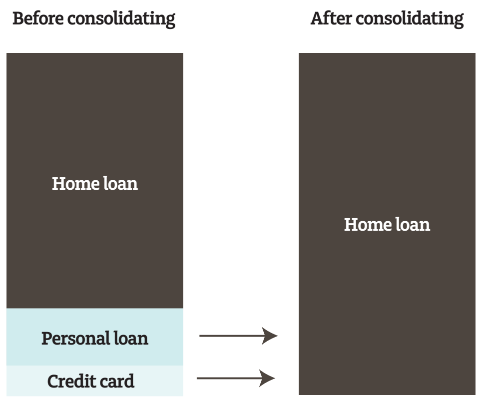
Consolidating certain debts into your mortgage could enable you to save interest and pay off your debts sooner.

How does the strategy work?

With this strategy, you need to:

- increase the mortgage on your family home, and
- use the extra funds to pay off other non-tax deductible debts (such as a personal loan or credit card) where the interest rates are generally higher than home loan rates.

By doing this you could potentially pay less interest, as the lower interest rate on your home loan will apply to all your debts, as the case study on the opposite page illustrates.



Maintain overall loan repayments

When consolidating debts, it's important you keep making at least the same overall loan repayments. Otherwise:

- it could take longer to pay off your combined debt, and
- you could end up paying more interest over the life of the loan, despite the lower interest rate.

Check loan features

It's important your home loan offers features that can enable you to pay off the combined debt quickly, such as a 100% offset account[1] or a redraw facility[2]. If it doesn't, you may want to consolidate your debts into a more flexible home loan.

Other key considerations

- You may need to pay refinancing costs, including loan application fees, stamp duty and early termination fees.
- You should ensure you have enough insurance to protect your income and cover loan repayments in the event of your death or disability.

Seek advice

A financial adviser can help you assess all the issues that need to be considered and determine whether debt consolidation suits your needs and circumstances.

[1] An offset account is a transaction account that is linked to a home (or investment) loan and the balance is directly offset against the loan balance before interest is calculated.

[2] If your home loan has a redraw facility, you can make extra payments directly into your loan and withdraw the money if necessary. You should confirm with your lender whether any fees apply.

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Case study

Carolyn and Ian are married with a young family. Their home is worth $600,000 and their debts total $415,000 (see table 1).

They want to pay off their debts as quickly as possible and save on interest. After assessing their goals and current debt position, their financial adviser makes a number of recommendations. The first is that they consolidate their debts by:

- increasing their home loan from $400,000 to $415,000, and
- use the extra $15,000 to pay off their personal loan and credit cards.

By doing this, the home loan interest rate of 7.5% pa will apply to all their debts and the total minimum repayment will drop from $3,448 to $3,271 a month.

Their financial adviser also calculates that if they continue to pay $3,448 into the consolidated loan each month, they will pay off their debts sooner and save $17,914 in interest (see table 2).

Note: If they make the reduced repayment of $3,271 per month, it will take them 20 years to repay their consolidated debt and the interest payments over this period will total $369,337, which is $27,741 more than if they hadn't consolidated their debts. This highlights why it's so important, when consolidating your debts, that you maintain the same total repayments rather than spend the interest savings.

[3] Assumptions: In both options, repayments of $3,448 are made for the life of the home loan. With the separate loans, payments are redirected to the home loan once the personal loan is repaid.

Table 1: Current debts

Debts	Outstanding balance	Interest rate	Current repayments (pm)
Home loan (20 year term)	$400,000	7.5%	$3,153
Personal loan (5 year term)	$10,000	13%	$223
Credit cards	$5,000	19%	$72
Total	**$415,000**		**$3,448**

Table 2: Separate loans vs consolidated loan

	Separate loans[3]	Consolidated loan[3]
Outstanding loan(s)	$415,000	$415,000
Monthly repayments	$3,448	$3,448
Remaining term	18 years 4 months	17 years 11 months
Total interest payments	$341,596	$323,682
Interest saving		**$17,914**

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A133935-0217