

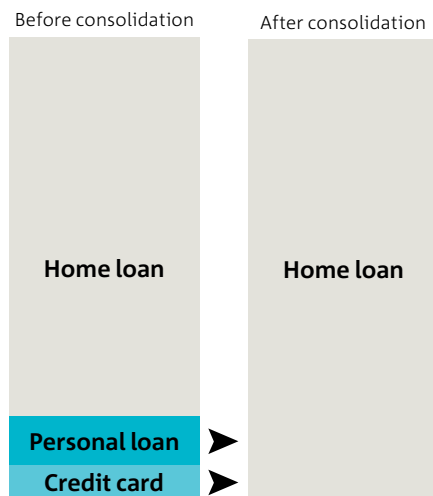
# Consolidate your debts *to save money*

If you have a range of inefficient debts, you may want to **consolidate them.**

## What are the benefits?

By using this strategy, you could:

- Save on 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 (assuming you have sufficient equity) and use the funds to pay off your other inefficient (non tax-deductible) debts, such as a personal loan or credit card.

By doing this, the lower interest rate payable on your home loan will apply to all your debts, thereby saving you interest.

However, it's also important that you continue to make the same overall loan repayments. If you don't:

- It could take longer to pay off the combined debt, and
- You could end up paying more interest over the life of the loan (despite the lower interest rate).

Before you consolidate your debts, you should find out if your existing home loan offers features – such as a 100% offset account or redraw facility – that can enable you to use other clever debt reduction strategies (see Strategies 2 and 3).

If it doesn't, you may want to consolidate your debts into a new home loan that offers these features.



## Case study

Steve, aged 37, and Karen, aged 35, are married with a young family. Their home is currently worth \$450,000 and they have the following debts:

Debts	Outstanding balance	Interest rate	Current repayments (pm)
Home loan (20 year term)	\$200,000	7%	\$1,551
Personal loan (5 year term)	\$25,000	12%	\$556
Credit cards	\$5,000	17%	\$66
Total	\$230,000		\$2,173

To minimise their total interest bill (and improve the manageability of their finances), they increase their home loan from \$200,000 to \$230,000 and use the additional \$30,000 to pay off their personal loan and credit cards.

As a result, the home loan interest rate of 7% pa will apply to all their debts and the total minimum repayment will reduce to \$1,783 – a cashflow saving of \$390 in the first month alone.

But rather than spending this cashflow saving, they will continue to pay \$2,173 into the consolidated loan each month – not just for the five years the personal loan would have lasted, but for the entire term of the consolidated loan.

This will enable them to pay-off the consolidated loan earlier and save \$13,513 in interest.

	Separate loans <sup>1</sup>	Consolidated loan <sup>1</sup>
Outstanding loan(s)	\$230,000	\$230,000
Monthly repayments	\$2,173	\$2,173
Remaining term	14.3 years	13.8 years
Total interest payments	\$142,531	\$129,018
Interest saving		\$13,513

If Steve and Karen had decided to make the new (reduced) minimum repayment of \$1,783 per month, it would have taken them 20 years to repay the loan, and the interest payments over this period would have totalled \$197,964.

This highlights why it is so important to maintain the same total repayments rather than spend the interest savings that may result from consolidating your debts.

**1** It is assumed in both options that repayments of \$2,173 per month are made for the life of the home loan. With the separate loans, once the personal loan is repaid these payments are re-directed to the home loan.

### Important information

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## Tips and traps

- Before implementing a consolidation strategy, you should consider the potential cost of re-financing your loans (eg application fees, stamp duty and early termination fees).
- If you have surplus cash you should consider using it to reduce personal loans or credit card debt, and avoid the need to consolidate your debts. If you are concerned about having access to emergency cash, you could consolidate your loans and place the surplus cash into the loan (with a redraw facility) or a 100% offset account.
- You should consider taking out income protection insurance to help meet your repayments if you are unable to work due to illness or injury.
- If you take out life insurance, you can ensure your dependants are not burdened with an outstanding loan in the event of your death, or forced to sell the secured asset (eg the family home) to repay the loan.



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