

Interest Only Loans & Repayment Types

WHO SHOULD USE AN INTEREST ONLY LOAN?

- Interest Only home loans are not designed for every type of borrower. For example, they are not recommended for standard owner-occupied home buyers.
- However, Interest Only loans can be very useful for property investors – that's because the interest on a loan for a property investment is usually tax deductible

HOW DO INTEREST ONLY REPAYMENTS DIFFER?

- You can expect your repayments to be lower initially if you commence your loan with an IO period. However, while the IO period is in place, you can also expect to be paying a higher rate of interest than if you started with P&I repayments from the outset.
- Because IO repayments will result in you paying more interest over the term of the loan, this option should only be chosen to fill a requirement that you have
- Even with an IO period in place, you may be able to reduce the principal during this time by making voluntary extra payments

THINGS TO CONSIDER

- You may not build any equity.
- The loan reverts to P&I as soon as the IO period ends
- Not all lenders allow extra repayments
- A loan with an IO period will cost more

WHAT ARE THE BENEFITS

- Smaller repayments. During the IO period of the home loan, your monthly repayments will be lower than with a P&I loan.
- Improved cash-flow. Lower repayments mean you could use your cash for other purposes that may be financially beneficial
- Maximise tax benefits for property investors. The interest on an investment property debt is usually tax deductible for property investors, as long as you follow the ATO rules.
- Benefits are ongoing for the life of the IO term

RATE LOCK

- Some lenders will provide you with the option of locking in the fixed rate prior to settlement occurring. This is referred to as "Rate Lock" and will involve paying a rate lock fee which will usually be calculated as a percentage of the loan amount.
- Most people who elect to Rate Lock do so at the time the application is submitted. It can be done later in the process – however, the lender can announce a rate increase at any time before settlement

OTHER INFORMATION

- The repayment on your mortgage will always include the interest payable on the amount borrowed, no matter what kind of loan you have. If you have a Principal & Interest loan (P&I), part of your repayment will also be allocated to reducing the balance of the loan.
- With an Interest Only loan (IO), your repayments only pay the interest that is due and do not reduce the balance (or the amount you borrowed). As a result, an IO loan can only be obtained for a limited period (usually up to five years). At the end of the IO period, the loan will automatically convert to a P&I loan unless you make an application to extend the IO period.