http://loanselect.smartonline.com.au/how-to-have-an-incredible-shrinking-mortgage/

Consider this: 30 years ago it cost about 3.5 times the average annual salary to buy an average priced Australian home — today, it costs around 7.5 times our yearly earnings (1). With the average new home loan nudging $444,0002, it's more important than ever to look at strategies to shrink your mortgage and work towards greater financial freedom sooner.

The trick is there is no trick. Unless you strike it rich, debt reduction always takes financial discipline and usually some sacrifice. But if you are prepared to prioritise your spending and adopt a long-term focus, there are ways to slash your mortgage and get ahead.

Get the right loan

With interest rates at historical lows, you might be lulled into thinking there is little to be gained by shopping around. Apart from possibly paying for features you don't need or missing out on a lower rate, you need to think beyond the here-and-now and consider your debt if interest rates climb.

Look for a loan that suits your circumstances. If you plan to make extra payments, consider a redraw facility that allows you to tap into the buffer you have built up, with no penalties or restrictions.

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Securing the lowest possible rate is important, but make sure the offer is not a honeymoon rate, which will expire in six or 12 months and may leave you paying a higher rate for the life of the loan than if you had borrowed elsewhere.

If switching lenders or to a new type of loan, make sure you weigh up the cost of any switching or early exit fees against what you expect to save before signing on the dotted line.

A mortgage broker can help you navigate and compare the hundreds of loans available to find the right one for your situation.

Make extra payments as soon as possible

You pay the most interest in the first few years of a loan when the principal is at its highest. The sooner you can start reducing your principal, the better.

Let’s say, for example, you start out with that average new home loan of $444,000, taken out for 30 years at 5.5 per cent per annum. And say you tip an extra $100 a month (a modest $23 a week) into the repayments. You would knock $84,951 or 2.7 years off your debt. Pay an extra $200 a month and save $147,930 or 4.89 years. Super-size that to $300 extra per month and you will slash a massive $203,054 or 6.71 years off your mortgage.

You should also pay any windfalls, such as tax returns or work bonuses, into your mortgage to chip away at the principal faster.

Set your savings to work

Another way to make big dents in your mortgage debt is to leverage any savings via an offset account. Basically your savings work for you because they are offset against your loan balance to reduce the amount of interest you pay. If you have a $200,000 loan, for example, and $20,000 in a savings account linked to your mortgage account, your interest repayment will be calculated on $180,000. To maximise your savings balance and cash flow management, have all of your income paid directly into the account and all of your expenses paid out of it. Hopefully, your cash in is greater than your cash out, so there are savings to offset against your loan. Maximise your savings further by putting as many of your expenses as possible on a 55-day interest-free credit card and pay the full balance by the due date. That allows you to

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maintain as much in your savings account for as long as possible each month, with interest on your home loan calculated daily but charged monthly. The example above is a very neat one to illustrate the concept. Your savings account will fluctuate depending on your monthly cash flow, and so will your interest repayments. As long as month on month, the savings are growing and the loan balance shrinking, you are heading in the right direction.

If you struggle to save or be disciplined with credit cards, this strategy may not be right for you. You might be better off setting up a direct debit straight from your pay for extra repayments on your loan.

Instead of an offset account your lender may offer you a line of credit, where all of your income and debt run in and out of the same account, so your mortgage basically becomes your transaction account. The more funds that go in – and stay in – the lower your interest repayment each month and the faster you pay down the debt. The problem is many borrowers find they are not disciplined enough to keep reducing the debt and tend to treat the available balance as disposable income. While they can work for shrewd owner-occupiers, lines of credit are generally better suited to property investors who are looking to negative gear and rely on capital gain over time.

Cash flow is king

You may be wondering where to find funds for extra loan repayments or how to stockpile savings in an offset account. It comes down to how you manage your cash flow, which is essentially how you prioritise your spending. Make an honest appraisal of your expenses each month and look for discretionary costs you can get rid of or cut back. It may mean eating out less, taking your own lunches to work, cleaning your own home, taking cheaper or fewer holidays or buying less expensive clothes. Most people who have made significant inroads on their mortgages faster than others have made sacrifices along the way. Think of it as short-term pain for long term gain, which is ultimately a better financial future.

Cash in on deductions

You still have time to make any tax deductable purchases before June 30. Check with the ATO what you can claim for your specific job if you are a PAYE employee.

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Small business owners have until June 30 this year to cash in on the $20,000 instant asset threshold. This allows you to immediately deduct the business use portion of a depreciating asset that costs less than $20,000.

Now is also the time to make tax-deductible donations to a registered charity of your choice.

If you are cashed up, you may be able to pre-pay some tax deductable expenses, such as accountant fees, interest costs on investments and some work-related expenses, for the next financial year. Check with your financial advisor to ensure you are eligible for pre-payments and they suit your situation.

1 ATO & ABS data

- ABS Average Weekly Earnings, Australia, May 2015
- ABS Average Weekly Earnings, States and Australia, March Quarter 1985 – published June 1985
- ABS Residential Property Price Indexes: Eight Capital Cities, Jun 2015
- RBA Dwelling Prices and Household Income, published December 2012

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