

OH DEAR INTEREST RATES ARE RISING

- Allistar Walker

11/6/10

The increase in the Official Cash Rate (OCR) of 0.25%, announced on 10 June, was well heralded by Mr Bollard. I hear a little bleating in the press that some people won't be able to afford higher mortgage rates and would have to sell. I wonder what sort of advice these people must have taken if they took out a mortgage at low rates, particularly when these low rates were always expected to rise at some point.

Is a Mortgage a Commodity?

One could be excused for thinking so, the way banks and other lenders have sought to lend at any cost over recent years. A mortgage is not a commodity, in that careful planning is required at the point of deciding to take one out. Fluctuating mortgage rates could be with us for many years. Already rates of over 8% are being mooted for a little over 2 years time. The mortgage is not the sort of product you can just take off the shelf to satisfy the moment, without taking into consideration the long term effects. This brings to mind the roots of the word mortgage. The mort – is from the Latin word *mori* (via old French *mort*) for death, and –gate is from the sense of that word meaning a pledge to forfeit something of value if a debt is not repaid. So mortgage is literally a death pledge. This bears some thinking about.

Some Winning Mortgage Strategies

While this article is not the place to reveal all our secrets, there are certain principles we adhere to when advising clients as to how to handle the long term commitment of a mortgage.

- What is your intention or plan to reduce the mortgage faster?
- Adopt a forward strategy or plan for repayments. We use a nominal rate of 8% over 25 years which we suggest people set their repayments at regardless of whether they will be paying a lesser interest rate. The reason for this is that average interest rates over the last 10 years have been between 7.5% - 8%. By adopting a higher repayment programme when interest rates are low, you will place yourself in 'credit' and may not need to increase payments when rates are higher.
- If you can't afford repayments at the 8% pa notional rate, then unless you have increased income coming, you possibly shouldn't be borrowing as much.
- You can spread interest rate risk by spreading loan over different fixed rate periods. Also you may wish to float some by a reducing loan or revolving credit, utilising your credit card to help drive down interest paid and hence overall debt.
- Have you got a contingency plan for emergency funding in case you are sick and no income is coming in?
- Will you be increasing repayments in line with salary increases to kill the monkey earlier?

Ultimately high debt can create a stranglehold and this is why planning and forethought can make a huge difference to your later life and wealth. Everyone's situation is different, but most people would benefit from well researched and experienced advice when setting up a mortgage. At the moment you are unlikely to get this in any worthwhile detail from your bank. To them it is still a commodity.

Care has been taken to ensure that any information is accurate. No liability is accepted for its use.

Allistar Walker is a Senior Fellow of Financial Services Institute of Australasia and an accredited mortgage/insurance advisor. His full disclosure is available at www.mortgagehelp.co.nz or he can be contacted at 410 6023 and enquiry@mortgagehelp.co.nz.